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No. 74

In the Supreme Court of the United States

OCTOBER TERM, 1936

AMERICAN TELEPHONE & TELEGRAPH COMPANY ET AL., APPELLANTS

v.

UNITED STATES OF AMERICA, FEDERAL COMMUNICATIONS COMMISSION ET AL., RESPONDENTS

BRIEF ON BEHALF OF THE NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

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INDEX

	Page
Opinion below	1
Statement of the case	1
Summary of argument	7
Argument	18
I. The "original cost" provisions of Order No. 7–C are not in violation of the due process clause of the fifth amendment of the Constitution	17
II. The "original cost" provisions of the order do not require appellants to keep their property investment accounts so as to misrepresent their investment in property	31
III. The "original cost" provisions of the order do not "prevent appellants from charging any depreciation expense on a part of their actual investment in depreciable property"	52
IV. The "original cost" provisions of Order No. 7–C do not "require a retroactive change in the accounts of utilities subject thereto"	64
V. The "original cost" provisions of Order No. 7–C are not "unreasonably burdensome and expensive", and they will serve important purposes that can not be equally well otherwise served	64
VI. The provision of the Commission's order that the amounts recorded in Account 100.4 "shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this commission may direct" is not a requirement which exceeds the power of the Commission	74
VII. The requirement of the Commission's Order, contained in Instruction 2 (b) 1 that "all charges to the accounts prescribed in the classification for telephone plant, income, operating revenues, and operating expenses shall be just and reasonable and any payments by the company in excess of such just and reasonable charges shall be included in Account 323, 'Miscellaneous Income Charges.'" is not arbitrary or unreasonable, nor beyond the authority of the Commission nor violative of the due process clause of the fifth amendment	89
VIII. The instructions contained in said Order No. 7–C with Respect to what property shall be entered in accounts 100.1, 100.3, and 103 do not deprive the appellants of their rights under the due process clause of the fifth amendment	93

103717—36——1

Argument—Continued. Page

IX. The provisions of Order No. 7-C challenged by the appellants are severable from the other provisions of said order, and the validity of the order, as a whole, does not depend upon the validity of those provisions 100

CITATIONS

Cases:

Accounting Rules for Telephone Companies, 203 I. C. C. 13 79
Atlanta Birmingham and Coast Railroad v. *United States*, 296 U. S. 33 84
Chesapeake & Ohio Ry. Co. v. *United States*, 5 Fed. Supp. 7 ..... 68, 84
Hecklin et al. v. *Coney et al.*, 290 U. S. 169 62
Interstate Commerce Commission v. *Oregon-Washington Ry. and Navigation Co.*, 288 U. S. 14 63
Kansas City So. Ry. Co. v. *United States*, 231 U. S. 423 ..... 39, 40, 68, 84, 93
Kansas City So. Ry. Co. v. *United States*, 282 U. S. 760 63
Lindheimer v. *Illinois Bell Telephone Co.*, 292 U. S. 150 ..... 54, 55
New York Edison Company v. *Maltbie*, 344 Appl. Div. N. Y. 685 ..... 10, 50, 52, 80
Norfolk & Western Ry. Co. v. *United States*, 289 U. S. 134 ..... 84, 87
Northwestern Bell Tel. Co. v. *Nebraska State Ry. Commission*, 80 Supreme Ct. Advance Opinions 552 54
Smyth v. *Ames*, 169 U. S. 466 31
St. Joseph Stockyards Co. v. *United States*, 80 Supreme Ct. Adv. Opinions 679 30
Telephone and Railroad Depreciation Charges, 177 I. C. C. 351 56
Uniform System of Accounts for Public Utilities and Licensees Subject to the Federal Power Act, Approved June 16, 1936, Effective January 1, 1937 .....
United States v. *Abilene and So. Ry. Co.*, 265 U. S. 274 100
West v. *Chesapeake & Potomac Telephone Co.*, 295 U. S. 662 ..... 31, 55

Statutes:

Communications Act of 1934:

Section 1 23
Section 4 (i) 76
Section 201 (a) 24
Section 201 (b) 24
Section 203 (a) 25
Section 203 (b) 25
Section 204 26
Section 213 (c) 64
Section 220 (a) 18, 67, 76, 84, 88
Section 220 (b) 19
Section 220 (c) 19
Section 220 (h) 20
Section 220 (i) 20

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OPINION BELOW

The opinion of the District Court (R. 561) is reported in 14 Fed. Supp. 121.

STATEMENT OF THE CASE

This is an appeal from the final decree of a specially constituted District Court for the Southern District of New York entered in a suit brought to enjoin enforcement of an order of the Federal Communications Commission prescribing a uniform system of accounts for telephone companies.

The action was instituted by the American Telephone and Telegraph Company and twenty-eight

of its principal subsidiaries (R. 1). Additional groups of telephone companies later appeared as additional plaintiffs (R. 222–237) or as intervening plaintiffs (R. 241–250).

The National Association of Railroad and Utilities Commissioners, described as "a voluntary Association, including in its membership the members of the railroad commissions, public service commissions, and other regulatory commissions and boards of the several States of the United States, except the States of Delaware and New York", filed a petition for leave to intervene as a party defendant, setting forth the part which had been taken by the State commissions, represented in the membership of said Association, in favoring the adoption of said order of the Federal Communications Commission, and their interest therein; and said Association was duly admitted as an intervening defendant (R. 266–271).

Said order of the Federal Communications Commission was designated as "Telephone Division Order No. 7–C." It was issued on June 19, 1935, to become effective January 1, 1936 (R. 91–92).

The District Court, after a hearing and after submission of the case for a final decree, granted a temporary stay of said order No. 7–C pending decision on the motion for an interlocutory injunction (R. 559–560); but the final decree of that court dissolved such temporary stay, and sustained said Order No. 7–C except with respect to two minor matters concerning which no appeal has been

claimed by any defendant. Enforcement of the order in those two respects was permanently enjoined (R. 584–586).

The accounting system for telephone companies, now in force, was prescribed by the Interstate Commerce Commission effective January 1, 1933 (R. 344 and 345). Upon objection of sixteen State commissions and of the Public Utilities Commission of the District of Columbia, the Interstate Commerce Commission took under advisement suggested changes in this 1933 system (R. 16). A hearing in the nature of argument was held (R. 15) before a single Commissioner, who had been given administrative charge of the proceeding, and the matter was submitted to the Commission without brief (R. 14). This submission was on June 15, 1933, but consideration was delayed because the Commissioner in charge was engaged upon other official duties (R. 14). Finally, on July 9, 1934, after the Federal Communications Commission had been appointed, but before it had organized, the Interstate Commerce Commission issued a report, without an order, as was stated by the Interstate Commerce Commission in the report, "in order that it (the new Commission) may be advised of our views" (R. 14). In this report some of the matters now objected to by the appellants were discussed and disapproved (R. 13–82).

Following its organization, the Federal Communications Commission, after an investigation and after conferences both with representatives of

the telephone companies and of the State commissions, adopted said Order No. 7–C revising the outstanding system of accounts for telephone companies. In such revision the accounting representatives of the State commissions in said conference concurred (R. 270).

The National Association of Railroad and Utilities Commissioners, at its convention following such adoption, by resolution, endorsed the system of accounts as promulgated in said Order No. 7–C and recommended its adoption by all State commissions having jurisdiction over telephone companies (R. 268–270).

Numerous grounds of invalidity of this order were asserted in the appellants' bill of complaint; but the matters relied upon in this court, and covered by their "Statement of Points" (R. 600–605) are the following:

(1) Said Order No. 7–C contains provisions which require that the accounts of each company accounting thereunder shall be kept in such form that the original cost of property to a public utility which first dedicated such property to public use shall be shown either in Account "100.1, Telephone Plant in Service", "100.2, Telephone Plant Under Construction", or "100.3 Property Held for Future Telephone Use", and any excess above such original cost which the accounting company may have paid in acquisition thereof in another account, "100.4, Telephone Plant Acquisition Adjustment" (R. 122–124).

"Original cost" is defined as "the actual money cost of (or the current money value of any consideration other than money exchanged for) property at the time when it was first dedicated to the public use, whether by the accounting company or by a predecessor public utility" (R. 101, S. 1).

If the original cost required to be recorded is not known, said Order No. 7–C requires that it shall be estimated (R. 108). It is further provided that the amounts recorded in said account 100.4, with respect to each property acquisition, "shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as the Commission may direct" (R. 124).

It is claimed by the plaintiffs, that these provisions are so arbitrary and unreasonable as to be beyond the authority of the Commission to prescribe, and that they deprive the appellants of their property, and of the right to keep a reasonable set of accounts, in violation of the Fifth Amendment to the Constitution of the United States (R. 600–601).

(2) The appellants also claim that the provision that the difference between the cost of property to the accounting company and the cost to the public utility which first dedicated such property to public use "shall be disposed of, written off, or amortized as the Commission may direct" is void, for the reason, as the appellants claim, that the Commission's power is limited to the making of rules and regulations of general application, and does not

extend to the making of orders of the character contemplated by the quoted provision (R. 601).

(3) The accounting order also provides:

> (B. 1) All charges to the accounts prescribed in this classification for telephone plant, income, operating revenues, and operating expenses shall be just and reasonable, and any payments by the company in excess of such just and reasonable charges shall be included in account 323, "Miscellaneous income charges" (R. 98).

The appellants contend that this requirement is so arbitrary and unreasonable as to be beyond the authority of the Commission, and that it deprives the appellants of their rights under the due process clause of the Fifth amendment of the Constitution of the United States (R. 602).

(4) Said order further requires that the property of an accounting company shall be classified, and that the original cost of property "used in telephone service at the date of the balance sheet" shall be kept in account 100.1, that the original cost of property "not completed, ready for service at the date of the balance sheet" shall be included in said account 100.2, and that the original cost of property "held for imminent use in telephone service under a definite plan for such use" shall be kept in account 100.3 (R. 122–123).

The appellants claim that the instructions contained in the order with respect to what property

shall be entered in each of said accounts are "so vague and indefinite as not to constitute a legal standard of conduct, and that they are accordingly arbitrary and violative of the due process clause of the Fifth Amendment of the Constitution of the United States (R. 603).

(5) These challenged provisions of Order No. 7–C are claimed to be non-severable, and the entire order void by reason of the invalidity of those provisions.

SUMMARY OF ARGUMENT

I

The "original cost" provisions of Order No. 7–C are not in violation of the due process clause of the fifth amendment of the Constitution.

In determining the extent of the power of Congress to regulate the accounts of telephone companies and in construing the act under which such power has been delegated to the Commission, the legitimate purposes for which such power is to be exercised will be taken into account. Accounts of public utilities serve various well recognized purposes which it will be assumed Congress meant to promote, and especially the purpose of rate regulation mentioned in Section 1 of the Communications Act as one of the purposes for which the Commission was created.

The duties of a commission such as the Federal Communications Commission extend far beyond the decision of cases presented to it by complaint. It has the affirmative duty to determine whether rate increases proposed by utilities shall be permitted to take effect without suspension and investigation, and likewise the continuing duty to consider whether the rates of each utility, subject to its jurisdiction, as to which no complaint has been made, are such rates as require no formal investigation by the Commission, or should be made the subject of such investigation. It is impossible for the Commission to perform these duties effectively, as to the great number of utilities subject to its jurisdiction, unless the accounts of such utilities classify, segregate and set forth the facts respecting their property and operations from which conclusions may be drawn as to fair value, and as to operating cost and operating income; and these facts must be so shown that they may be quickly seen and considered.

Accounting systems now in effect fall far short of meeting the needs of regulatory commissions. Rate proceedings are notoriously prolonged, due largely to the delays incident to accounting investigations which are now necessary to obtain from the accounts, or from other sources, information which ought to be carried upon the face of the accounts. The uniform system of accounts, prescribed by Order No. 7–C represents an earnest at-

tempt on the part of the regulatory commissions of the country, both Federal and State, to improve the instrumentalities with which they work, so that they may perform their duties intelligently and with reasonable expedition.

II

The "original cost" provisions of the order do not require appellants to keep their property investment accounts so as to misrepresent their investment in property.

Order No. 7–C does not require that any part of the cost of its property be obliterated from the accounts of any utility, but merely requires a classification of such property and a segregation of original cost, as defined, from additions thereto which may have been included in the price paid for such property upon purchase of the same by one utility from another, after its dedication to public use. The accounts in which original cost is recorded, and Account 100.4, in which excess of purchase price above such original cost is recorded, taken together, will show the full purchase price of property to the accounting company; and will continue to show such full cost unless and until the amounts recorded in Account 100.4 shall be in whole or in part required to be written off by some subsequent order of the Commission.

The fact that after an item, now to be recorded in Account 100.4, under the provisions of Order No.

7–C, shall have been written off, the accounts will thereafter no longer show the full purchase price is no ground of invalidity. The right of an appellant to carry in its asset accounts any aggregate amount as a statement of assets value depends upon whether it in fact holds assets which that amount fairly represents. Order No. 7–C requires only that amounts in excess of original cost which a utility may have paid upon acquisition of property shall be recorded in Account 100.4, and subjected to the scrutiny of the Commission.

A utility can not hereafter be required to write off all or any part of any item recorded in that account unless the facts justify such order. If the facts justify the retention of the item, in whole or in part, as a true statement of asset value, it will then remain, to the extent justified; but if the facts justify an order requiring it to be written off it will properly disappear from the statement of property value made by the company's accounts.

Order No. 7–C is in direct contrast to the order of the New York Commission as construed by the New York courts in *New York Edison Company* v. *Maltbie,* 244 App. Div. N. Y. 685, in that every item recorded in Account 100.4, under the New York order, was required to be written off without regard to the particular surrounding facts, whereas Order No. 7–C leaves the items recorded in Account 100.4 to be hereafter dealt with upon the basis of the facts of each particular case.

III

The "original cost" provisions of the order do not "prevent appellants from charging any depreciation expense on a part of their actual investment in depreciable property."

It is not true that no depreciation may be charged against the amounts recorded in Account 100.4. It is true that no depreciation on such amounts may be charged without permission from the Commission, and that when charged it will be denominated "amortization" and recorded in Account 613 instead of Account 608. To the extent that the facts of any case justify the amortization of any item in Account 100.4 by charges to operating expense, as for depreciation, such charges will be allowed, but to that extent only.

This limitation upon the appellants in the matter of charges for depreciation is probably the gravest objection to the order from their point of view, but it constitutes one of the most necessary provisions of the order for the promotion of the essential purposes of the Communications Act. The point at issue is plain. Order No. 7–C permits all companies to make charges to operating expense, without further order of the Commission, for depreciation of their depreciable property computed upon the basis of the cost of that property when it was first dedicated to public use, but forbids further charges without permission of the Commission, to be obtained upon a showing that the facts justify further charges.

A public utility has no constitutional right to compute and record depreciation charges upon the entire amount which it may have paid for depreciable property, regardless of the relationship between seller and purchaser and of the actual value of the property purchased. Such a claim is negatived by *United Railways* v. *West,* 280 U. S. 234. The true purpose of depreciation accounting is succintly set forth in *Lindheimer* v. *Illinois Bell Telephone Company,* 292 U. S. 150.

The assertion that Order No. 7–C prevents claiming depreciation upon amounts recorded in Account 100.4 assumes arbitrary action hereafter upon the part of the Communications Commission. Such assumption will not be entertained by the court, and, furthermore, is inconsistent with the Commission's purpose, as testified to by its Chief Accountant, and is contrary to finding VIII of the court below.

IV

The "original cost" provisions of Order No. 7–C do not "require a retroactive change in the accounts of utilities subject thereto."

V

The "original cost" provisions of order No. 7–C are not "unreasonably burdensome and expensive", and they will serve important purposes that can not be equally well otherwise served.

Original cost is a relevant factor in the determination of value which has been repeatedly recog-

nized by this court. Congress has recognized its importance, and has expressly authorized the Commission to require any company subject to the Communications Act to report as to its property "the original cost at the time of dedication to public use", to be ascertained from the accounting records or estimated.

The purposes to be served by showing such cost upon the face of the accounts, in the manner provided by Order No. 7–C are such as to make the Commission's order fairly and reasonably within the grant of power from Congress.

The appellants have greatly exaggerated the difficulty and cost of complying with the order. Whatever cost will be involved will be principally incident to the ascertainment or estimation of original cost, and that expense has been expressly sanctioned by Congress.

So long as the Commission acts within the grant of power conferred by Congress, its orders are not subject to judicial review.

VI

The provision of the Commission's order that the amounts recorded in Account 100.4 "shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this commission may direct" is not a requirement which exceeds the power of the Commission.

Various considerations move purchasing utilities to pay prices in excess of original cost. Some of these have no relation to value, and some of them are proper to be taken into account in fixing the base upon which to compute rates and annual depreciation charges. In order that the Commission may properly exercise its functions, the accounts of utilities must be so kept that they will show upon their face amounts which should be taken into consideration as representing value for said purposes. They will show this only if the amounts recorded in Account 100.4, which utilities pay upon transfers among themselves in excess of original cost, are eliminated from the accounts insofar as they do not represent asset value. No general order can be framed to provide for such elimination, the necessity for which must be determined upon the facts peculiar to each case.

The Commission's power is adequate. In addition to the general grant of power to prescribe accounts, contained in Section 220 (a), the Commission under Section 4 (i) has power to make any order not inconsistent with the Act which may be necessary in the exercise of its functions.

The appellants are contending for, as an alleged constitutional right, the privilege of overstating their property accounts, and of charging to operating expenses depreciation computed upon such overstated accounts. It is common knowledge that in recent years great numbers of consolidations of utility properties have been made for the purpose

of securing profits from the distribution of an increased volume of securities. The device of the holding company has facilitated the transfer of titles to operating properties at prices bearing no real relation to value.

If regulatory commissions are to exercise their functions effectively they must have power to examine into statements of cost, and to require such changes in accounts to be made as may be necessary to cause them to state the facts which they purport to state, and in a manner uniform for all companies. Under Order No. 7–C the accounts of all utilities subject to the Commission will show the cost of their operating property upon a uniform basis—that of original cost—and will show also, in Account 100.4, whatever amounts additional thereto paid by accounting utilities the Commission has adjudged to represent asset value, and to be proper to be retained as a basis for rates and for charges to operating expense, as for depreciation.

The action of the Interstate Commerce Commission in failing to adopt said "original cost" provisions, which action is cited by the appellants, is of no significance as tending to support the assertion that they are unreasonable and arbitrary. The Interstate Commerce Commission has had little, if any, experience in the regulation of rates of public utilities, upon the basis of the value of the property of individual utilities, and involving utility claims for depreciation expense, and hence was not

in a position to appreciate the necessity for the regulations in question.

The action of twenty-two State commissions in urging the "original cost" provisions before the Interstate Commerce Commission, the action of the Federal Communications Commission in promulgating Order No. 7–C, the action of State commissions in adopting similar orders in various States, as in New York and Wisconsin, and in approving said accounting order through their National organization, and the action of the Federal Power Commission in adopting substantially identical provisions in its accounting order recently promulgated, are far more significant insofar as concerns the necessity, reasonableness, and alleged arbitrariness of such original cost provisions, than the failure of the Interstate Commerce Commission to adopt such regulations, after a brief argument before a single commissioner, without supporting evidence.

VII

The requirement of the Commission's Order, contained in Instruction 2 (b) 1 that "all charges to the accounts prescribed in the classification for telephone plant, income, operating revenues, and operating expenses shall be just and reasonable and any payments by the company in excess of such just and reasonable charges shall be included in Account 323, 'Miscellaneous Income Charges,'" is not arbitrary or unreasonable, nor

beyond the authority of the commission nor violative of the due process clause of the fifth amendment.

VIII

The instructions contained in said Order 7–C with respect to what property shall be entered in accounts 100.1, 100.3, and 103 do not deprive the appellants of their rights under the due process clause of the fifth amendment.

IX

The provisions of Order No. 7-C challenged by the appellants are severable from the other provisions of said order, and the validity of the order, as a whole, does not depend upon the validity of those provisions.

ARGUMENT

The original cost provisions of Order No. 7–C are not in violation of the due process clause of the fifth amendment of the Constitution

The appellants in their Statement of Points to be relied upon in this court (R. 601) assert that the original cost provisions of said order No. 7–C are in violation of the due process clause of the Fifth Amendment in that:

a. They require appellants to keep their property investment accounts so as to misrepresent their investment in property.

b. They prevent appellants from charging any depreciation expense on a part of their actual investment in depreciable property.

c. In effect, they require a retroactive change in the accounts of transactions entered into with governmental approval, the records of which have been correctly kept in accordance with rules prescribed by law.

d. They are unreasonably burdensome and expensive and serve no useful purpose except the recording of information which, when needed, could be made available, in supplementary statements, pursuant to Section 213 (c) of the Communications Act of 1934, at relatively minor expense and without causing the accounts to misrepresent the facts.

We will discuss these several points separately. But before doing that we desire to discuss generally the extent of the Commission's power to regulate accounts, the proper construction of the original cost provisions of Order No. 7–C, and the obvious purpose to be served by accounts kept in accordance with those provisions. This general discussion will be applicable to various of the points to be later separately discussed.

The Congress, in the Communications Act of 1934, has granted to the Federal Communications Commission power to regulate accounts in the broadest terms. The principal provisions of that statute relating to accounting are set forth in the margin.[1] Certain other provisions which supple-

[1] Sec. 220. (a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, in-

ment the provisions quoted in the margin will be hereinafter set forth in this brief in the course of our discussion of particular points.

In determining the extent of the power of Congress to regulate the accounts of telephone companies, and in construing the act under which such power has been delegated to the Commission, the legitimate purposes for which such power may properly be exercised will be taken into account.

The Communications Act does not state the purpose of the grant of power with respect to accounts aside from the general declaration found in Sec-

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cluding the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

(c) The Commission shall at all times have access to and the right of inspection and examination of all accounts, rec-

tion 1 of the Act which is set out below at page 23. However, the annual reports of public utilities, and the accounts on which they rest, serve various well recognized public purposes, some of which are recited on page 27 of the brief of the appellants. It is to be assumed that the Congress designed to promote these well recognized purposes among others, and especially that it designed to promote the purposes mentioned in said Section 1, including rate regulation.

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ords, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by such person. Any provision of law prohibiting the disclosure of the contents of messages or communications shall not be deemed to prohibit the disclosure of any matter in accordance with the provisions of this section.

* * * * *

(h) The Commission may classify carriers subject to this Act and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with the public interest, except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations.

The appellants misconceive the purpose and the effect of the original cost provisions of Order No. 7–C. On page 21 of their brief they say:

> That part of the Commission's order which requires property purchased from another utility to be carried in the companies' investment accounts at the amount it cost that former owner which first devoted it to public use, and which requires that the difference between that figure and the amount paid for it by the accounting company be placed in an adjustment account, to be disposed of, written off, or amortized as the Commission may direct * * * obviously has its foundation in a theory that the cost to the predecessor company fixes the basis for rate making. No other explanation of these rules suggests itself.
>
> * * * To carry this theory to a logical conclusion, the Commission should have made a rule that the amount in the "adjustment" account should be immediately charged to surplus. In this respect the Commission lacked the courage of its convictions. Instead, it has attempted to avoid the issue by merely providing that amounts in the adjustment account shall be disposed of as the Commission may direct, without stating any principle on which it proposes to act. Its ultimate purpose may be carried out under cover of this power.

If the Commission entertains such "ultimate purpose" as the appellants suppose, and if in pursuance thereof it shall make an unlawful order,

any company affected may thereupon have recourse to the courts. Until such order shall have been made, however, the appellants will have no cause for complaint. *Norfolk & Western Railway Company* v. *United States,* 287 U. S. 134, 141. The appellants, however, for some reason undertake to support their claim that the original cost provisions of Order No. 7–C are unreasonable and arbitrary, and upon that ground unconstitutional by asserting this assumed "fallacious theory" of the Commission at the outset of their argument, on page 21, and as the first point set out in their "Summary" on page 18.

There is nothing in Order No. 7–C itself, nor to be found in the record, which justifies the assertion that the order rests upon a theory that the original cost of property when first dedicated to public use, whether such cost was paid by the present owner or by a predecessor company, "fixes the basis for rate making." The assertion of appellants that this is the theory upon which the order rests and the suggestion that the Commission entertains the "ultimate purpose" of exercising its rate regulatory powers upon that theory, attributes to the Commission an ignorance of the law, or a disposition to disregard the law, which this court will not attribute to that honorable body. It will be assumed that the Commission knows the fundamental rule of rate making laid down in *Smyth* v. *Ames,* 169 U. S. 466, and that it will be governed thereby.

While no proper use of original cost suggests itself to the appellants, such proper use will be obvious to the court. Original cost is not value, and does not fix value. It is, however, evidence of value.

The duties of a Commission, such as the Federal Communications Commission, extend far beyond the decision of cases instituted by complaints of those who receive utility service. The Commission has the affirmative duty to determine whether rate increases, when proposed by a utility, shall be permitted to take effect without suspension and investigation. It has likewise the continuing duty to consider whether the rates of each company subject to its jurisdiction which are in effect, and as to which no complaints have been made to the Commission, are such rates as to require no specific investigation by the Commission, or whether in any particular case they should be made the subject of a formal investigation, in a proceeding in which all interested parties may be heard, and in which whatever order is appropriate changing such rates may be made.

The provisions of the Communications Act of 1934 which impose the duties just mentioned upon the Federal Communications Commission are those immediately hereinafter set forth. The italics appearing therein are supplied.

> *Section 1. For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make*

available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, *there is hereby created a commission to be known as the "Federal Communications Commission", which* shall be constituted as hereinafter provided, and which *shall execute and enforce the provisions of this Act.*

Section 201. (a) It shall be the duty of every common carrier engaged in interstate or foreign communication by wire or radio to furnish such communication service upon reasonable request therefor; and, in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with other carriers, to establish through routes and charges applicable thereto, and the divisions of such charges, and to establish and provide facilities and regulation for operating such through routes.

(b) *All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just*

and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is hereby declared to be unlawful: * * *

SECTION 203 (a). Every common carrier, except connecting carriers, shall, within such reasonable time as the Commission shall designate, file with the Commission and print and keep open for public inspection schedules showing all charges for itself and its connecting carriers for interstate and foreign wire or radio communication between the different points on its own system, and between points on its own system and points on the system of its connecting carriers or points on the system of any other carrier subject to this Act when a through route has been established, whether such charges are joint or separate, and showing the classifications, practices, and regulations affecting such charges. Such schedules shall contain such other information, and be printed in such form, and be posted and kept open for public inspection in such places, as the Commission may by regulation require, and each such schedule shall give notice of its effective date; and such common carrier shall furnish such schedules to each of its connecting carriers, and such connecting carriers shall keep such schedules open for inspection in such public places as the Commission may require.

(b) *No change shall be made in the charges, classifications, regulations, or practices which have been so filed and published*

available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, *there is hereby created a commission to be known as the "Federal Communications Commission", which* shall be constituted as hereinafter provided, and which *shall execute and enforce the provisions of this Act.*

Section 201. (a) It shall be the duty of every common carrier engaged in interstate or foreign communication by wire or radio to furnish such communication service upon reasonable request therefor; and, in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with other carriers, to establish through routes and charges applicable thereto, and the divisions of such charges, and to establish and provide facilities and regulation for operating such through routes.

(b) *All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just*

and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is hereby declared to be unlawful: * * *

SECTION 203 (a). Every common carrier, except connecting carriers, shall, within such reasonable time as the Commission shall designate, file with the Commission and print and keep open for public inspection schedules showing all charges for itself and its connecting carriers for interstate and foreign wire or radio communication between the different points on its own system, and between points on its own system and points on the system of its connecting carriers or points on the system of any other carrier subject to this Act when a through route has been established, whether such charges are joint or separate, and showing the classifications, practices, and regulations affecting such charges. Such schedules shall contain such other information, and be printed in such form, and be posted and kept open for public inspection in such places, as the Commission may by regulation require, and each such schedule shall give notice of its effective date; and such common carrier shall furnish such schedules to each of its connecting carriers, and such connecting carriers shall keep such schedules open for inspection in such public places as the Commission may require.

(b) *No change shall be made in the charges, classifications, regulations, or practices which have been so filed and published*

except after thirty days' notice to the Commission and to the public, which shall be published in such form and contain such information as the Commission may by regulations prescribe; * * *.

SECTION 204. *Whenever there is filed with the Commission any new charge, classification regulation, or practice, the Commission may* either upon complaint or *upon its own initiative without complaint, upon reasonable notice, enter upon a hearing concerning the lawfulness thereof; and pending such hearing* and the decision thereon the Commission, upon delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, *may suspend the operation of such charge, classification, regulation, or practice*, but not for a longer period than three months beyond the time when it would otherwise go into effect; *and after full hearing the Commission may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective.* If the proceeding has not been concluded and an order made within the period of the suspension, the proposed change of charge, classification, regulation, or practice shall go into effect at the end of such period; but in case of a proposed increased charge, the Commission may by order require the interested carrier or carriers to keep accurate account of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid,

> and upon completion of the hearing and decision may by further order require the interested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased charges as by its decision shall be found not justified. At any hearing involving a charge increased, or sought to be increased, after the organization of the Commission, the burden of proof to show that the increased charge, or proposed increased charge, is just and reasonable shall be upon the carrier, *and the Commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible.* [Italics ours.]

Every commission vested with general regulatory powers such as those which have been imposed upon the Federal Communications Commission must exercise those powers as to every company subject to its jurisdiction. It is clear that its duties can not be properly performed unless the law provides means and instrumentalities whereby information may be available to the Commission as to the facts which are necessary to be known in order that the Commission may at any time form an intelligent judgment concerning the probable reasonableness and lawfulness of the rates of any of the numerous utilities subject to its jurisdiction.

The reports which companies are required to make, and the accounts upon which they rest, have

been designed to supply information for the consideration and guidance of the Commission. They serve the occasional purpose of supplying evidence for use in formal rate proceedings, and they serve the much more important purpose of supplying to the Commission information which it may use in the performance of its continuing duty to act or to withhold action on its own motion concerning the rates of each accounting utility.

To serve this latter purpose, the accounts must do more than carry information which can be searched for, and compiled, and reported upon, by expert accountants. They must classify and segregate and set forth the facts from which, as to any company, conclusions may be drawn as to the fair value of its property devoted to the public use, the expense of operating such property, and the income derived from such operation; and these facts must be shown in such manner that they may be quickly seen and considered. The Commission can not have frequently recurring audits made of the accounts of the great number of utilities over which it exercises jurisdiction. In order that it may do its work with proper expedition, the information which it desires must be available to it upon the face of the reports of each utility, so that it may be considered at any time without the great cost and the delays which are unavoidably involved in accounting investigations.

The requirements imposed upon public service corporations as to the form in which their accounts

shall be kept, and as to the reports they shall make, have been changed from time to time, and always for the purpose of increasing their usefulness to the public or to public officials; but such systems of accounts now in effect fall far short of meeting fully the needs of regulatory Commissions. Rate investigations are notoriously prolonged, and much of the delay is due to the fact that the accounts of utilities have not been so kept as to make the information they contain, or should contain, readily available. It results that prolonged accounting investigations are required to obtain and bring necessary evidence into formal proceedings from the accounts or other sources; and it results also that commissions are ordinarily compelled to reach their informal conclusions concerning the desirability of action on their own motion, by way of institution of formal proceedings, without information of facts which the reports of the utilities ought to make quickly and easily available.

The Uniform System of Accounts for Telephone Companies, prescribed by the Federal Communications Commission in its Order No. 7–C, and recommended by the National Association of Railroad and Utilities Commissioners to the State commissions for their adoption, represents an earnest attempt on the part of the regulatory commission of the country, both Federal and State, to improve the instrumentalities with which they work, so that they may perform their duties intelligently and with reasonable expedition.

In his dissenting opinion in *St. Joseph Stock Yards Co.* v. *United States,* 80 Supreme Ct. Advance Opinions, 679–672, Mr. Justice Brandeis commented on the long delays which have been incurred in the application of the rule of *Smyth* v. *Ames* in rate cases. These delays he referred to as seriously impairing the power of rate regulation, and as justifying the Congress in making the findings of fact of the Secretary of Agriculture in rate proceedings before him conclusive.

Commenting upon such delays, in the case then before the court, Mr. Justice Brandeis said:

> The history of this case illustrates that regulation cannot be effective unless the legality of rates prescribed may, if contested, be determined with reasonable promptness.

It is indeed essential to the effectiveness of regulation that it shall be possible with reasonable promptness to present to the courts the facts upon which the legality of prescribed rates may be determined, if such legality is challenged; but it is even more essential to the success of regulation that regulatory Commissions, themselves, for their current information and guidance, shall have knowledge of those facts upon which the legality of the rates they prescribe will be determined by the courts if they shall be challenged, so that they may prescribe rates which will meet the legal tests which have been laid down by the courts.

The rule in *Smyth* v. *Ames* 169 U. S. 466, is now conclusively settled, as a rule which must be followed when the constitutionality of rates is drawn in question. Furthermore it was held in *West* v. *Chesapeake & Potomac Telephone Co.,* 295 U. S. 662, that a Commission in its legislative proceedings must reach its conclusions from data which meet the tests established by judicial decisions.

The changes in accounting methods and practices which the uniform system of accounts here under attack requires are designed to make available to the Commission, upon the face of reports rendered by reporting utilities, the evidentiary facts necessary to be known by the Commission, which now are obtainable only at the cost of long and expensive accounting investigations.

The "original cost" provisions of the order do not require appellants to keep their property investment accounts so as to misrepresent their investment in property

The appellants assert in their Statement of Points that the original cost provisions of the order require them to keep their property investment accounts so as to misrepresent their investment in property (R. 601).

Upon this point the findings of the court are as follows:

III

Telephone Division Order No. 7–C requires plaintiffs to include in the telephone

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plant accounts the "original cost" of their telephone plant, and provides that the difference between said original cost and cost to the accounting company of property acquired from another public utility shall be recorded on their books in other specified investment accounts.

IV

Plaintiffs have heretofore performed accounting with respect to property acquired from other public utilities which resulted in the inclusion in their telephone plant accounts of amounts representing various costs, such as current cost new, actual cost to plaintiffs, structural value, or cost to the predecessor company (by merger of book accounts). The Uniform System of Accounts prescribed by Telephone Division Order No. 7–C requires that in accounting for property acquired from another public utility, and in all other instances, plaintiffs' telephone plant accounts shall be stated on a uniform basis, that being "original cost", as therein defined.

V

Telephone Division Order No. 7–C does not require that the recorded cost or investment of the plaintiffs in property theretofore acquired by them from another public utility be obliterated or eliminated from their investment accounts, but merely requires plaintiffs to segregate the element of recorded cost or investment into the following investment accounts:

100.1 Telephone plant in service.
100.2 Telephone plant under construction.
100.3 Property held for future telephone use.
100.4 Telephone plant acquisition adjustment.

VI

Telephone Division Order No. 7–C further requires plaintiffs to include in their investment accounts the amount which they actually pay for property acquired on and after January 1, 1936, from other public utilities.

IX

Telephone Division Order No. 7–C requires that plaintiffs' accounts shall be kept on a basis which will reflect the facts with respect to their transactions and which will show their actual condition for the information of all persons interested therein, except with respect to contributions to predecessor utilities and depreciation of property held for future telephone use, and said order is capable of practical application except with respect to contributions to predecessor utilities.

The appellants have excepted to Findings III, IV, and VI upon the assertion that Account 100.4 is not an investment account, and they also have excepted to Finding IX. The findings, however, are fully supported by the plain terms of the order itself, and likewise by the evidence. Reference is made to the affidavits of Norfleet, R. 469–477;

Bickley, R. 504–526 and R. 516–518; Colbert, paragraphs (A), (B), and (C), R. 525–526; Orton, paragraphs (A), (B), and (C), R. 534–535; Smith, paragraphs (A), (B), and (C), R. 545–546 and (A), (B), and (C), R. 547–548.

The appellants, to support their contention, rely upon arguments contained in affidavits of their accountants all of which assert the opinion that Account 100.4 is not to be regarded as an asset account. Appellants' affidavits are fully met by the affidavits offered by the Commission and just referred to. The discussion of the court below touching this matter is as follows:

> The new system requires that when telephone plant in service is acquired, the amount paid therefor shall be charged to account 276 (Telephone plant acquired). The original cost of the property, estimated if not known, shall then be charged (debited) to the appropriate telephone plant account, whether "in service" (100.1), "under construction" (100.2), or "held for future use" (100.3) and credited to account 276. After debits to 276 for "contributions", and for reserve requirements for depreciation and amortization to date of the plant acquired, the amount remaining in 276 shall be debited or credited as appropriated to account 100.4 (Telephone plant acquisition adjustment). As to 100.4, the system provides: "The amounts recorded in this account with respect to each property acquisition shall be disposed of, written off, or provision shall be

made for the amortization thereof in such manner as this Commission may direct (100.4 (c)). "Original cost" as used is defined as "the actual money cost of or the current money value of any consideration other than money exchanged for property at the time when it was first dedicated to the public use, whether by the accounting company or by a predecessor public utility" (instruction 3–S–1).

The plaintiffs direct at this requirement the objection that these provisions violate the fundamental principles of accounting in the following respects; although 100.1, 100.2, 100.3, and 100.4 if added together immediately will show the company's actual investment in its plant, since 100.4 must be written off at the will of the Commission, it will be necessary to carry a surplus reserve against this possible write-off. Once the write-off has been made, they declare that no combination of balances will reflect the company's actual investment. And they object further, because there can be no depreciation charge to any amount in account 100.4.

In considering the merits of these objections, it becomes necessary to examine, for purposes of comparison, the system now in effect which the plaintiffs do not attack as unreasonable and which they seek to retain. Under the present system, account 278 "undistributed cost of property" performs a function similar to account 100.4. Under it, when a purchase is made, the estimated cur-

rent value of the land, the current cost new (estimated if not known) of certain other telephone plant, the original cost of franchises, and the cost of uncompleted projects are charged to their corresponding accounts. After crediting to reserve accounts, the estimated depreciation and amortization applicable, the difference between the total of the foregoing amounts and the cost to the accounting company of the plant acquired is debited or credited to 278, "undistributed cost of property." Account 278 is classed as a "telephone plant account" and is reported in the balance sheet as part of account 100 (Telephone plant).

As an alternative, the Commission may permit the transfer of the amounts in the "telephone plant accounts" and in "depreciation and amortization reserve accounts" as carried in the books of the vendor company to the books of the purchaser. In some instances, the amounts actually paid by the purchasing companies have been recorded in the "plant" accounts. Thus, actual cost, current cost new at the time of purchase, and original cost at the time of first dedication are in use at present as the basis of various telephone plant accounts. The amount in 278 of the present system is subject to no depreciation and may be written off only through surplus

On a comparison of the two systems, that of this Commission seems to more accurately reflect the condition and record the history

> of the plant. Account 100.4 is listed among investments. It can be subdivided so that there can be segregated any amount therein not representing (1) the cost of elimination of competition; (2) payment to an affiliate at a price in excess of cost to it with a profit returnable to the purchasing company in the form of dividends or otherwise; and (3) any other element not expended in public interest.
>
> This segregated amount would receive the same treatment substantially in the rate and depreciation basis as would amounts appearing in 100.1 "Telephone plant in service." In this light, it appears that the proposed system merely provides segregation, and that the addition of the amounts in these investment accounts 100.1 through 100.4 would accurately picture the legitimate investments of the purchasing company (R. 566–568).

The appellants argue that after items have been written out of Account 100.4, no combination of figures appearing in Accounts 100.1 to 100.4, inclusive, will show the true investment of the company in its plant. They strenuously asert that this violates the fundamentals of correct accounting.

The contention involves the assumption that it is the right of the appellants to have their asset accounts show the total amount paid for property acquired regardless of the extent and condition of that property. The accounting system now in force, as prescribed by the Interstate Commerce

Commission, does not permit that, and this court has negatived that claim.

Under the accounting system now in force, while the cost of purchased property of an accounting company is entered in the asset accounts of the company, the estimated amount of reserve requirements applicable thereto is required to be credited to Account 171, "Depreciation Reserve" ((C) R. 366), to be carried as a liability. The principle is thus recognized that the accounts should state the asset value of the property purchased. The defect of the system lies in the fact that no method is provided for assuring that the full purchase price entered in the accounts represents consideration paid for asset value of plant property.

Under Order No. 7–C, the accounts of any company will show the total amount paid for any property unless and until the Commission shall require any amount recorded in Account 100.4 to be written off in whole or in part. If the extent and character of property purchased, and the facts affecting a particular case, are such as to satisfy the Commission that asset value was not obtained to the full amount of the purchase price paid in excess of original cost, so that the Commission is justified in requiring a company to write off any item or items of Account 100.4, in whole or in part, the asset accounts of the company will thereafter reflect not the total amount expended by the company in the acquisition of its property, but the

portion thereof which is represented by the asset value of property acquired and still in service. This is the proper purpose of asset accounts.

This was the question in principle which was involved in *Kansas City Southern Railway Company* v. *United States,* 231 U. S. 423. In that case the carrier improved its road by constructing certain new sections, and abandoning old sections where the grades were unduly heavy. The Commission required the cost of the abandoned sections to be written out of the carrier's accounts.

The Kansas City Southern contested the Commission's order upon the ground that the regulation was so entirely at odds with the fundamental principle of correct accounting as to manifest an abuse of power. In sustaining the Commission's order, the court said:

> The contention of the appellant that property, originally acquired because necessary in the construction of the road, and afterwards abandoned only because rendered unnecessary by the improvement and development of the property, should remain in the property account as a part of the stockholders' investment, will be found, upon analysis, to rest upon the unwarrantable assumption that all capital expenditures result in permanent accretion to the property of the company. This in effect ignores depreciation—an inevitable fact which no system of accounts can properly ignore. A more complete depreciation than

> that which is represented by a part of the original plant that through destruction or obsolescence has actually perished as useful property, it would be difficult to imagine (231 U. S. 306).

The right of an appellant to carry amounts in its asset accounts representing any given aggregate depends upon whether it has assets which represent those amounts. If it has, then there is nothing in Order No. 7–C which prevents carrying those accounts in its asset accounts. That order, as we have seen, requires only that where amounts in excess of the original cost of property have been paid by an accounting utility, the excess payments shall be recorded in Account 100.4, and subjected to the scrutiny of the Commission. If the facts are such as to justify the retention of any excess in whole or in part in Account 100.4, it there remains, to the extent justified, as a statement of asset value, but if the facts are such as to justify the Commission in requiring that the same be written off, then it will properly disappear from the statement of the company's assets, just as did the cost of the abandoned road bed in the *Kansas City Southern case.*

The aforementioned erroneous assumption of the appellants' accountants upon which rests appellants' contention that the original cost provisions of Order No. 7–C are arbitrary and unconstitutional, is itself based upon an insistent misunderstanding of the provisions of Account 100.4.

The appellants' Affiant Kester in his affidavit asserted as follows:

> The difference between the owner's investment and the investment of the prior owner *will be shown temporarily* in an "adjustment" account, *but this must be extinguished,* either immediately or later, at the pleasure of the Commission. * * * *It is true that so long as the "difference" remains in the "adjustment" account, it is technically listed as an asset of the company, but since its extinction is mandatory and may be immediate if the Commission so wills, it would not be regarded as an asset in anything but name.* The accounts list it as an asset, but label it as an asset to be charged off, and therefore impliedly worthless. In actuality, it is a deferred charge against surplus, since the Commission can make it such a charge at any time, and the company could not safely regard it except as a deduction from surplus. In practical effect, the situation is no different while the amounts in Account 100.4 are listed among the assets than it is after they are charged off (R. 327–328). [Italics ours.]

It is upon this construction, by which the Commission's order is made to require every item in Account 100.4 to be written off, that the appellant's contention rests. It is an erroneous construction.

That the amounts written into Account 100.4 are listed as assets while they there remain even the appellant's affiants admit. The Affiant Kester's language, touching this point, we have just quoted above. Mr. Sangster said:

> Said rules require that the actual cost of property purchased by the carrier from another utility shall be charged in part to one or other of the three accounts above mentioned and in part to account "100.4 Telephone plant acquisition adjustment." But, as previously noted, *the amounts standing in account 100.4 are subject to the arbitrary rule that they shall be disposed of* as directed by the Commission in some manner unknown to the accounting company. * * * In particular the balance sheet would show (as it must) an account designated "100.4 Telephone plant acquisition adjustment" which, to the minds of most persons reading the same, would be either unintelligible or would convey the impression that it represented *an asset of dubious character"* (R. 311–312). [Italics ours.]

Affiant Maddèn said:

> While the balance in account 100.4, Telephone Plant Acquisition Adjustment, is listed as an investment asset (p. 25), *the extinguishment of the balance is mandatory* (Account 100.4 C, page 28), and may be proximate or remote as the Commission may direct (R. 320). [Italics ours].

The Affiant Heiss said:

> The difference between the owner's investment and the investment of the prior owner will be shown temporarily in an "adjustment" account, but this must be extinguished, either immediately or later, at the pleasure of the Commission. *While this "difference" is technically listed as an asset of the company so long as it remains in the "adjustment" account, it will not be regarded as an asset in anything but name, since its extinction is mandatory* and may be immediate if the Commission so wills. The accounts list it as an asset, but label it as an asset to be charged off and therefore impliedly worthless. *In actuality it is a deferred charge against surplus, since the Commission can make it such a charge at any time* (R. 338). [Italics ours.]

It will be noted that the affiants are a unit in recognizing the character of Account 100.4 as an asset account, and that they treat the setting aside of the asset elements there listed as a characterization of them as "dubious" and "impliedly worthless" only because they understand that by the Commission's order they are required to be written off from surplus, so that the placing of an item in Account 100.4 has in effect stamped it as a "deferred charge against surplus."

The construction thus placed upon the language quoted from Account 100.4 disregards the obvious meaning of that language. "Disposed of, written

off, or provision shall be made for the amortization thereof" is made to mean always and only "written off."

This construction in effect rejects the words "disposed of", or treats them as purely tautological. A proper construction gives effect to all of the quoted words. They permit that any amount which is written into account 100.4 shall be treated in one of three ways. It may be (1) assigned to its proper place in the company's accounts and there retained; or (2) it may be written off forthwith, or (3) it may be marked for gradual extinction by amortization either through charges to operating expenses or to income.

The appellants' construction disregards the primary meaning of the phrase "disposed of", which is that here suggested, "to find a place or use for", and attributes to it instead its secondary meaning which is "to get rid of."

Funk & Wagnalls Practical Standard Dictionary defines "dispose" as follows:

> *Dispose*—1. To set in order; arrange; settle. 2. To direct the mind of; incline. 3. To order or appoint; regulate. 4. To make over; bestow, or alienate, as property; now generally dispose of. II. i. To arrange or settle something. *to dispose of.*—1. To find a place or use for. 2. To part with; get rid of.

Websters New International Dictionary defines "dispose" as follows:

> *Dispose,* v. t.—1. To distribute and put in place; to arrange; to set in order; as to dispose the ships in the form of a crescent. 2. To assign to a certain place or condition; opposit. 3. To regulate; adjust; settle; determine. 4. To deal out; to assign a use to; to bestow for an object or purpose; to apply; to employ; to dispose of. 5. To give a tendency or inclination to; to make ready; prepare; adopt; especially to incline the mind to; to give a bent or propension to; to incline to make inclined * * *.
>
> *Dispose,* v. t.—1. To arrange or settle matters finally; to make disposition of; * * *. 2. To bargain to make terms * * *. *to dispose of—a.* to determine the fate of; to fix the condition, employment, etc., of; to direct or assign for a use. *b.* to get rid of; to put out of the way; to finish with * * *.

The accountants who wrote the provisions of account 100.4, as adopted by the Commission, used the phrase "disposed of" as the lexicographers use it.

Any given item in Account 100.4 the Commission, upon the facts of a particular case, may "dispose of" by finding and assigning to it a proper place in the accounts of the Commission (and such proper place may be Account 100.4 where it will stand marked as an investment properly made by

the accounting utility in the acquisition of property, in excess of the original cost of that property to a prior owner), or the Commission may require that it be written off at once, or it may require that it be amortized over a term of years either through charges to income, or through charges to operating expenses, as for depreciation.

That this is the proper construction of the language under consideration is shown by the affidavits of the Commission's accountants who prepared the classification, and by the construction placed upon it by other utility accountants of broad experience.

Mr. Norfleet, who for 16 years was with the Interstate Commerce Commission, as Examiner, Chief Accountant, and Auditor, now Chief Accountant for the Federal Communications Commission who was the principal advisor of the Commission in the preparation of the new accounting system (R. 468–469) says:

> Affiants for plaintiffs say that the amounts to be recorded in Account 100.4 must be extinguished either immediately or later at the pleasure of the Commission, and that such amounts are a deferred charge against surplus, since the Commission can make it such a charge at any time. *This is purely speculative and unsupported by the system of accounts,* the general rules of which govern the disposition of items not specifically provided for. *The affiants may just as well have made the proper assumption, namely, that*

the disposition of the amounts to be recorded in Account 100.4, "Telephone plant acquisition adjustment" would be disposed of, after the character of the item had been determined, in a manner consistent with the general rules underlying the uniform system of accounts for the distribution of expenditures, according to their character, to operating expenses, income, surplus, or remain an investment (R. 476.) [Italics supplied].

The Affiant Bickley, formerly Chief Accountant of the Wisconsin Public Service Commission, and now Chief Accountant of the Telephone Investigation being conducted by the Federal Communications Commission, in his affidavit said:

I do not understand this to mean that the Commission shall direct telephone companies to write off all of the adjustment account by deductions from surplus. It is my opinion that the Commission has given recognition to the various factors which may account for the amount in the adjustment account and has provided for the individual consideration thereof in the light of the facts as they are determined. (R. 511.)

* * * Furthermore, *the Commission, in its administration of account 100.4, might direct that all or a part of an amount included therein be classified as amounts applicable to buildings, pole lines, etc., according to the facts in the case.* There is nothing in the system which prohibits telephone

> companies from making this classification. It may not be assumed, however, that all amounts included in account 100.4 can or should be identified with various classes of plant. For example, if the account includes an amount for going value, the propriety of distributing this intangible to the tangible classes of plant is very doubtful. In fact, Kester, in his published writings, says that "good will" should be reported separately on the balance-sheet. (R. 517.) [Italics supplied.]

Mr. Colbert, Acting Director of Accounts for the Wisconsin Public Service Commission, referring to the provisions of 100.4 in his affidavit, said:

> (B) In my opinion these instructions considered together mean that when the accounting utility shall have determined the amounts includible in Account 100.4, Telephone Plant Acquisition Adjustment, it should submit full details concerning the same to the Commission and that thereupon the Commission will issue such order regarding the disposition of the amounts as is warranted by the facts in the case. *This means that the amount might be permanently retained in the investment accounts,* depreciated or amortized over the life of the property, or subject to such other disposition as might be appropriate for the items included in Account 100.4. (R. 527.) [Italics supplied.]

Mr. Orton, Director of Research of the Public Service Commission of New York, for 17 years a

utility accountant with a varied experience, in his affidavit said:

> E. The Bills of Complaint and affidavits submitted therewith object to the provision of paragraph C of account 100.4, Telephone Plant Acquisition Adjustment, providing that "the amounts recorded in this account with respect to each property acquisition shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission may direct." *This provision is interpreted as meaning that the commission may arbitrarily, without hearing or justification as a matter of correct accounting, at any time require the writing off of any portion or all of the balances contained in this account. I do not so interpret it. I do interpret it as meaning that the Commission will decide in the case of each acquisition, or perhaps in the case of the initial entry effecting all of the present property of the company in the case of the amounts then entered as a whole, what the accounting procedure shall be; and that this decision will be made after hearing, if hearing is desired by the company concerned,* and will be based upon the general policy regarding accounting and the treatment of depreciation laid down by the Federal Communications Commission and its predecessor the Interstate Commerce Commission after extensive hearings and upon sound accounting practice (R. 535–536). [Italics supplied].

Whether the appellants will be injured by orders made under the provisions of Account 100.4 depends upon what the Commission understands the provisions of the accounts to require, and what it will accordingly direct the appellants to do to conform thereto.

Chief Accountant Norfleet is the man who presided over the conferences with State commission representatives preceding the adoption of the accounting order. He, more largely than anyone else, acted for the Commission in formulating the order, and by virtue of his position he will have supervision of its enforcement (R. 469–470). What he says as to the meaning of the requirements in question should be taken as the construction which the Commission gives to those requirements, and will follow in its enforcement thereof.

The appellants have cited the decisions of the New York courts in *New York Edison Company* v. *Maltbie,* 244 App. Div. N. Y. 685 and 271 N. Y. 103–685. We think it well to comment briefly upon the difference between that case and this case, which renders the New York opinions inapplicable here.

The construction placed by the New York courts upon the order of the New York Commission, like the construction of a statute of a state by the highest court of the State, must be taken to settle the meaning of that order in New York, where the same was designed to have application. What the New York Commission's order required was stated in the opinion of the Appellate Division of the Su-

preme Court (sustained in a memorandum opinion by the Court of Appeals) as follows:

> * * * Account 143 is entitled "suspense to be amortized." This account, as required by the first paragraph of the instructions in relation thereto, is to "include losses in service value of property retired from causes for which provision has not been made in the depreciation reserves and losses from retirements which could not reasonably have been foreseen and provided for." It also "shall include any excess cost to the company of property purchased over the amount which is determined by the commission" to be the amount which the property cost the first public utility owner. The ultimate disposal of items placed in this account is shown by the last paragraph of the instructions. "Charges shall be made to this account only upon order of the Commission and *shall be written off* over such period and in such manner as the commission may by order prescribe." [Italics ours.]

It thus appears that any amount paid by a utility upon acquisition of utility property in excess of the original cost of that property was, by the New York order, *marked for amortization without inquiry, and without regard to facts which might justify such payment and render the amount paid a true statement of asset value. The order itself left no alternative disposition open. Without exception every item representing any such excess pay-*

ment was to be written out of the accounts of the utility by which the same was made.

Under the order of the Communications Commission, in contrast, as we have pointed out, each such payment is to be subjected to the Commission's scrutiny in the light of the facts surrounding the same, and if such facts warrant, it will "otherwise dispose of" the item than by causing the same to be either written off at once or amortized. The order of the Commission is flexible, permitting the requirement imposed in each particular case to be determined by the facts of that case.

This quality of flexibility was wholly absent from the New York case. Upon this point the court below said:

> This flexibility distinguishes the system at bar from that held invalid in *New York Edison Company* v. *Maltbie,* 244 A. D. (N. Y.) 685 (R. 568).

The "original cost" provisions of the order do not "prevent appellants from charging any depreciation expense on a part of their actual investment in depreciable property"

The appellants assert that the provisions of order No. 7–C "prevent appellants from charging any depreciation expense on a part of their actual investment in depreciable property." This assertion refers to the amounts recorded in Account 100.4.

It is not true that no depreciation may be charged against the amounts, in Account 100.4. It is true that no depreciation upon such amounts may be charged except as the Commission, after consideration of the facts in any case, may permit; and it is also true that such amounts as are permitted are charged to "Amortization of intangible property", Account 613, instead of being denominated "Depreciation" and charged to Account 608 (R. 186). As we have before pointed out, the effect of Order No. 7–C is simply to set aside amounts recorded in Account 100.4 for the consideration of the Commission, and for disposition according to its order. It is to be presumed that the Commission will be governed by the facts in each case; and that when, and to the extent that, such amounts represent payments which ought properly to be depreciated through amortization charges to operating expense, it will so order. If, upon application, in a proper case it shall fail to grant its permission for proper charges to operating expense, the company is not without remedy, as was pointed out in the opinion below, hereinafter quoted.

We recognize that this limitation upon the appellants in the matter of their charges for depreciation, whereunder they may not charge depreciation upon items recorded in Account 100.4 without justifying such charges to the Commission, is probably the gravest objection to Order No. 7–C from their point of view. At the same time it consti-

tutes one of the most necessary provisions of the order for the promotion of the essential purposes of the Communications Act.

The point at issue is very plain. At page 25 of their brief, the appellants state as follows:

> Furthermore, the Commission should not have any discretion in the matter. If depreciation charges are to be based on cost there should be an absolute rule for using a company's own cost as the basis, and not the cost of another company.

Under Order No. 7–C, the basis for depreciation charges, so denominated, is made the original cost of the property depreciated when it was first dedicated to the public use. The duty of the rate paying public to keep that investment good through operating expense is recognized, regardless of changes in ownership of the property; but the charging to operating expense of anything beyond the amount necessary for that purpose, under the guise of depreciation, is forbidden unless and until permitted by the Commission upon a showing of justification therefor upon the facts in the particular case where such charge is to be made.

It has been demonstrated to this court in former cases, in which some of the principal appellants were parties, that unjust exactions have been long practiced upon the public through overcharges for depreciation. *Lindheimer* v. *Illinois Bell Telephone Company,* 292 U. S. 150. *Northwestern Bell Telephone Co.* v. *Nebraska State R. Commission,*

Vol. 80, No. 10, Supreme Ct. Advance Opinions, 552.

This case is the first in which it has been asserted in this court that a public utility has a constitutional right to compute and record depreciation upon the entire amount which it may have paid for depreciable property regardless of the relationship between seller and purchaser, and of other circumstances surrounding the transaction, and of the actual value of the property purchased. The decision of this court in *United Railways* v. *West*, 280 U. S. 234, we submit, negatives this asserted right.

The appellants argue that the cited case was a rate case, and hence inapplicable. It can not be inapplicable unless it shall be held that, for some reason inherent in the Constitution of the United States, Congress has no power to require that public utilities shall restrict charges upon their books to operating expense for depreciation to amounts which approximate the depreciation actually incurred.

The true purpose of depreciation accounting and the possibility of its abuse were succinctly stated by this court in *Lindheimer* v. *Illinois Bell Telephone Company*, 292 U. S. 150, as follows:

> Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. * * * According to the practice of the Company, the depreciation reserve is not held as a sepa-

> rate fund but is invested in plant and equipment. As the allowances for depreciation, credited to the depreciation reserve account, are charged to operating expenses, the depreciation reserve invested in the property thus represents, at a given time the amount of the investment which has been made out of the proceeds of telephone rates for the ostensible purpose of replacing capital consumed. If the predictions of service life were entirely accurate and retirements were made when and as these predictions were precisely fulfilled, the depreciation reserve would represent the consumption of capital on a cost basis, according to the method which spreads that loss over the respective service periods. But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide in effect capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return (292 U. S. 167, 168, 169).

That, as a matter of current bookkeeping, it is not practicable to make entries upon the basis of a shifting value is quite true. The discussion quoted in appellants' brief from *Telephone and Railroad Depreciation Charges,* 177 I. C. C. 351, had relation to this difficulty. The reasons which led the Interstate Commerce Commission in that case

to refrain from attempting to base depreciation charges upon the value of property were stated in the paragraph immediately following that which is quoted in appellants brief, as follows:

> Beyond question, the evidence before us strongly supports the use for accounting purposes of original cost to the accounting company as the basis for depreciation charges. It is a method which can be readily applied, ensures a high degree of stability in operating expenses, and enables managements to anticipate future needs with reasonable confidence. On the other hand, the present value method would be difficult to apply and supervise, and would tend toward instability and uncertainty. Added to this, we have a record in which the representatives of State commissions and municipalities, the telephone companies, and the gas and electric companies are all agreed that originial cost should be used as the base; we have accounting regulations for all classes of carriers which have been in effect for many years, which uniformly prescribe original cost (or ledger value) as the base, and which have never been contested in court, or until recently even criticized, because of this fact; and finally we have evidence that the use of original cost as the base for depreciation charges has been approved by numerous other Federal and State authorities, including the Supreme Court of the United States for income tax purposes, and that this is the base which is in general

> use in the business world. The evidence is ample to show that the use of this base is "sustained by expert opinion and approved by experience" and that it "is not arbitrary in the sense of being without reasonable basis" (177 I. C. C. 381).

Considerable light upon the problem which confronts regulatory commissions may be obtained from a reading of the very able report which has thus been brought to the attention of the court by the appellants. If the brief paragraph quoted by them would give the impression that it was the opinion of the Interstate Commerce Commission that no attempt should be made to make recorded depreciation charges coincide as closely as possible with expired service value, a glance at that part of the report beginning at page 397 under the caption "Depreciation in Accounting and in Valuation" will remove that impression. We quote the following:

> In our prior report we pointed out the direct and intimate connection between the accrued depreciation of a property which must be considered in its valuation and the annual charges for accruing depreciation which should be included in the accounts. This connection has been recognized from the beginning by the railroads and furnishes the key to their contentions. * * * The telephone companies, however, repudiate the logic of their own position with respect to depreciation expense and deny, appar-

ently, that it has any intimate relation to depreciation in valuation. * * * They also say that our declaration on page 356 of the prior report that "it is essential to bear in mind, however, that there is an inseparable connection between the straightline method and the principle that accrued depreciation represented by the reserve must be deducted in ascertaining the rate base value", and similar statements appearing elsewhere in that report, are contrary to fact and law. It appears, moreover, from evidence of record, that in rate cases before State commissions the telephone companies contend that their depreciation reserves should be disregarded in valuation, and that for the latter purpose depreciation should be limited to the observed deterioration of the property. It was shown, for example, that one telephone company having a depreciation reserve equal to about 30 per cent of the recorded investment in the property contends that the depreciation for valuation purposes is no more than 9 per cent; and this illustration is typical. * * * The present position of the telephone companies, as we understand it, is that the accounting does not purport to follow the actual rate of consumption of property during individual accounting periods; that it is equitable, and sound as a matter of practical accounting, to spread the depreciation expense in equal annual charges over the service life of the property in question; but that the actual

> rate of consumption, and hence of accrual of depreciation, may be quite different (177 I. C. C. 397, 398, 399).

The Interstate Commerce Commission did not approve the position taken by the telephone companies, but stated its conclusion as follows:

> We have no difficulty in reaching the conclusion that the real measure of depreciation is the extent to which service capacity has been exhausted; that wear and tear, obsolescence, inadequacy, etc., are all factors in depreciation, information as to which constitutes evidence to be given appropriate weight in determining the extent to which service capacity has been exhausted; that although inspection may be helpful, the best estimate of the exhaustion of service capacity as of a particular date can be made only by a careful analysis of past experience and the application of informed judgment as to future trends; that, with the possible exception of the effect of insufficient maintenance, such an analysis will provide a more reliable estimate of the loss in service capacity than observation alone; *and finally that the principles are identical which govern the estimating of loss in service capacity for both accounting and valuation purposes* (177 I. C. C. 408). [Italics ours.]

Touching this matter of depreciation, the court below said:

> This complaint (that the order prevents charging depreciation upon amounts recorded in account 100.4) anticipates arbi-

> trary action by the Commission, under 100.4 (c) which authorizes handling of this item through amortization. The effect would be the same as writing down through depreciation, and until the Commission acts so that the accounts become so contrary to the principles of correct accounting as to constitute the Commission's order arbitrary and unreasonable, the Commission is within its powers. The court need not agree the accounting proposed is the best method, but at this stage it cannot be said the provision is arbitrary. The objection is made that the Commission's refusal to act properly within 100.4 (c) would constitute a negative order, nonreviewable within the doctrine of *Proctor & Gamble* v. *United States,* 225 U. S. 282. This would not cut off the plaintiff's right of attacking the system as it would apply to them after such refusal. The appeal need not be on the order denying relief but can be against the system as its operation is affected by such denial (R. 568).

The evidence relating to this matter of depreciation upon items recorded in Account 100.4 may be found in the affidavits presented by the Commission as follows: Norfleet, paragraph 23, R. 276; Bickley, R. 512; Orton, paragraph G, R. 537; and Smith, R. 550. The statement of Chief Accountant Norfleet is as follows:

> 23. The Commission's system of accounts looks specifically to allowing telephone companies to recover, through charges to operating expenses for depreciation, the

> "original cost" of depreciable property. It also looks to segregating such "original cost" from the cost of acquiring property from predecessor companies and further to the recovery of the differences, if the conditions and circumstances contributing to such differences warrant recovery, through charges to operating expenses for amortization (R. 476).

Where various constructions of an order of a Commission, or of a statute, are possible, the court will not choose that which would make its constitutionality doubtful, but the reverse, for the reason that the court will not presume upon the part of the legislature, or its agent, the purpose to exceed its powers. On this point we call attention to the construction by this court of the South Carolina Motor Vehicle Act, in *Hicklin et al.* v. *Coney et al.*, 290 U. S. 169, 176. In that case the construction placed upon the act by the South Carolina Commission, as shown by the affidavit of the Superintendent of its Motor Transportation Division, was accepted as showing the effect of the statute upon the complaining truck owner. We quote from the opinion:

> The State court did not express disagreement with the Commission's construction * * *. Nor have we anything before us to show that the statute is being enforced and the exemption construed in any other sense. Upon the present record, it appears that the exemption is applied with two limi-

tations, first, that, as construed by the state court, it can refer only "to one whose principal business is that of a farmer or dairyman and not to one merely incidentally engaged in farming or dairying", and, second, under the construction of the Commission in enforcing the statute—a construction not disapproved by the state court—that it applies only to farmers and dairymen who occasionally, and not as a regular business, transport farm or dairy products for compensation. We cannot say that a classification based on such a use of the highways is an arbitrary one and thus encounters constitutional objection (290 U. S. 169, 178).

See also *Interstate Commerce Commission* v. *Oregon-Washington Railway and Navigation Co.*, 288 U. S. 14, 41, and *Kansas City Southern Railway Co.* v. *United States*, 282 U. S. 760, 764.

Upon this point the finding of the court below was as follows:

VIII

The plaintiffs are not prevented by Telephone Division Order No. 7–C from recovering amounts included in Account 100.4 in view of the alternative provisions of paragraph (C) of the text of said Account 100.4, which make provision for the amortization or other appropriate disposition of amounts included in Account 100.4. The Commission has made no direction with respect to the disposition of any such amounts (R. 575).

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The "original cost" provisions do not "require a retroactive change in the accounts of utilities subject thereto"

The order does not require a change in the record of accounts of utilities which have been kept in the past, as appellants in their Statement of Points assert (R. 601). It requires that henceforth certain accounts shall be kept in a different form than heretofore. This will necessitate a recasting of accounts, just as every other system of accounts has required a recasting of accounts as theretofore kept, insofar as changes were deemed necessary and prescribed. This is very forcibly pointed out by Mr. Orton, Director of Research and Valuation of the Public Service Commission of New York, in his affidavit (Paragraph H., R. 537), and by Chief Accountant Norfleet of the Federal Communications Commission (Paragraphs 32 and 33, R. 479).

The "original cost" provisions are not "unreasonably burdensome and expensive", and they will serve important purposes that can not be equally well otherwise served

Original cost, as we have before said, is a relevant factor in the determination of value repeatedly recognized by this court. Congress has recognized its importance, and has expressly authorized the Commission to require its ascertainment or estimation. Section 213 (c) of the Communications Act provides as follows:

> (c) The Commission may at any time require any such carrier to file with the Com-

mission a statement showing the original cost at the time of dedication to the public use of all or of any part of the property owned or used by said carrier. For the showing of such original cost said property shall be classified, and the original cost shall be defined, in such manner as the Commission may prescribe; and if any part of such cost cannot be determined from accounting or other records, the portion of the property for which such cost cannot be determined shall be reported to the Commission; and, if the Commission shall so direct, the original cost thereof shall be estimated in such manner as the Commission may prescribe. If the carrier owning the property at the time such original cost is reported shall have paid more or less than the original cost to acquire the same, the amount of such cost of acquisition, and any facts which the Commission may require in connection therewith, shall be reported with such original cost. The report made by a carrier under this paragraph shall show the source or sources from which the original cost reported was obtained, and such other information as to the manner in which the report was prepared, as the Commission shall require.

Upon this point the court below said:

> The requirement that original cost be set forth in accounting records of the telephone companies serves to complete the picture of value in revealing the property's financial

> background and showing the relationship of a carrier's monetary return to the original as well as to its own investment. It aids the Commission in its duty to determine from all the pertinent circumstances and factors the just and reasonable rates which the carrier may exact from its service. Original cost is a relevant factor. *Smyth* v. *Ames,* 169 U. S. 466, 547; *Los Angeles Co.* v. *R. R. Comm.,* 289 U. S. 287, 306, cf. paragraph 213 (a) of the Act. The object of the system of accounts might well be to display the pertinent financial operation and throw light upon its present condition. *Kansas City Southern Ry.* v. *U. S., supra,* at p. 440. Original cost as a segregated item on a balance sheet may serve to reveal actualities which may be pertinent in fixing a rate base on the capitalized earning power of a property purchased. In making readily available facts which would tend to expose discrepancies in valuation, it cannot be said the system is so arbitrary as to be beyond the commission's power (R. 566).

While conceding the relevancy of original cost in valuation proceedings, and the right of the Commission to call for the same under the provisions of Section 213 (c), the appellants object to the showing of such original cost upon the face of their accounts. Their argument is based upon the assertion that such information will be usable only in valuation proceedings, and that the statement of the same in the accounts is a useless expense.

Whether the segregation and showing of original cost is useful or not is a matter which has been committed by Congress to the Commission for decision. Power has been granted in the broadest terms. The act provides:

> Sec. 220 (a). The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

It is for the Commission to determine what accounts shall be set up, and in what manner the accounting companies shall subdivide and show therein their investments, the business which they do, and the revenue which they receive therefrom, and the expenses which they incur in connection therewith.

Discussing the exercise of power granted to the Interstate Commerce Commission in the identical language of the above quoted Section 220 (a) (which in the Interstate Commerce Act is Section 220 (5)) this court has said:

> Within broad limits that body's determination is necessarily beyond revision and correction by the courts. * * * If we were in disagreement with the Commission as to the wisdom and propriety of the order, we are without power to usurp its discretion and substitute our own (*Norfolk & Western Ry.* v. *United States,* 287 U. S. 134, 141).

The rule as established by decisions of this court was succinctly stated by Judge Soper, in handing down the decision of a statutory court in *Chesapeake & O. Ry. Co.* v. *United States et al.*, 5 Fed. Supp. 14, as follows:

> It is well settled that, if an attack upon the accounting methods prescribed by the commission is to be successful, it must rest at bottom upon a showing that they are so entirely at odds with fundamental principles of correct accounting as to manifest an abuse of power. So long as the commission acts fairly and reasonably within the granted power conferred by Congress, its orders are not subject to review. *Kansas City Southern Ry.* v. *U. S.*, 231 U. S. 423, 444, 456, 34 S. Ct. 125, 58 L. Ed. 296, 52 L. R. A. (N. S.) 1; *Norfolk & Western Ry.* v. *U. S.*, 287 U. S. 134, 141, 53 S. Ct. 52, 77 L. Ed. 218. (5 Fed. Supp. 14.)

In *Kansas City Southern Railway* v. *United States*, 231 U. S. 423, 452, this court had before it a case where the Interstate Commerce Commission had required the cost of considerable sections of abandoned road bed to be charged to operating expenses. The railroad protested that if such cost was to be written off at all, it should be charged to surplus. In its opinion, touching this point, the court said:

> The suggestion apparently has force; but, upon consideration, we are unable to see that it furnishes ground for judicial inter-

ference with the course pursued by the Commission. Except for the contention (already disposed of) that the value of the abandoned parcels should be permanently carried in the property account as part of the cost of progress, it is and must be conceded that sooner or later it must be charged against the operating revenue, either past or future, if the integrity of the property accounts is to be maintained; and it becomes a question of policy whether it should be charged *in solido* to profit and loss (an account presumptively representative of past accumulations) or to the operating accounts of the present and future. If abandoned property is not charged off in one way or the other it remains as a permanent inflation of the property accounts, and tends to produce, directly or indirectly, a declaration of dividends out of capital. If it be charged off to the surplus account, it tends to prevent the declaration of dividends based upon a supposed accumulation of past earnings. If charged to operating expenses of the current and future years, it has a tendency to prevent the declaration of dividends from current earnings until the amount of the depreciation shall have been made up out of the earnings.

But, did we agree with appellant that the abandonments ought to be charged to surplus or to profit and loss, rather than to operating expenses, we still should not deem this a sufficient ground to declare that the Commission had abused its power. So long

> as it acts fairly and reasonably within the grant of power constitutionally conferred by Congress, its orders are not open to judicial review (231 U. S. 423, 456).

That the purposes to be served by showing the investment of an accounting company, in the manner provided by the order of the Communications Commission, are of such character as to mark the Commission's action as "fairly and reasonably within the grant of power" contained in Section 220 (a) of the act, is, we believe, quite clear. One of the Commission's most important duties, as we have before indicated, is that of acting as the guardian of the public interest with respect to rates. When rate changes are proposed, which to the Commission seem likely to affect the public interest unjustly, it is the Commission's duty to suspend the same and to permit the changes to take effect only after the Commission has become satisfied as to their reasonableness; and likewise whenever rates in effect appear to the Commission to be unreasonable in any respect, it is the Commission's duty, upon its own motion, to enter upon an investigation in which the justice and reasonableness of such rates may be passed upon, and other rates prescribed if the facts warrant.

It is obvious that the information which accounts, kept as prescribed by the Commission's order, will supply will be of great value to the Commission in the performance of this duty. The original cost of all property will be shown. What this

information will be was stated by the Commission's Chief Accountant, Mr. Norfleet, in his affidavit as follows:

> 18. With respect to property acquired from another public utility, the accounting performed under this Commission's system will disclose, by a simple combination of appropriate accounts, the following information in the accounts of the purchasing company:
>
> (a) The cost of the property to the accounting company.
>
> (b) The original cost (as defined in instruction 3S–1 of the uniform system of accounts) of the telephone plant, governmental franchises, and other similar rights acquired.
>
> (c) The amounts of depreciation and amortization applicable to the property represented by item (b) above.
>
> (d) The original cost of telephone plant under construction at date of purchase.
>
> (e) The original cost of property held for future telephone use acquired in the purchase.
>
> (f) The amounts contributed to the predecessor company or companies for construction and acquisition of the telephone plant acquired.
>
> (g) The net of all the foregoing amounts segregated and shown separately in the balance sheet in an account styled 100.4, "Telephone plant acquisition adjustment" (R. 474–475).

If there is an approximate correspondence, in the case of any utility between the original cost of its property, as shown by its accounts, and the amount which the utility paid for the same property, the Commission will naturally consider that the amount paid (in the absence of any contrary claim by the utility or on behalf of the public) should be considered as probably approximating a proper rate base. If, however, there is a great and unexplained excess of alleged cost of acquisition over and above what the property originally cost, the Commission will properly make some investigation before accepting the price paid as a proper base either for the determination of a fair return or for the determination of annual depreciation charges.

To be useful for the purpose just mentioned, with respect to the great number of companies subject to the jurisdiction of the Commission, the original cost must be easily available upon the face of the annual reports rendered by utilities to the Commission. In a rate case a company may, if it will, claim that amounts additional to original cost, as recorded in the accounts, must be included in the investment in operating property to be considered in fixing the rate base, or it may claim that the income or expense accounts overstate or understate actual income or expense. It can not be denied, however, that accounts kept in accordance with the provisions of Order No. 7–C will enable relevant facts to be expeditiously shown, which now can be

shown only after prolonged accounting investigations.

The appellants have laid stress upon the alleged difficulty and cost which may be involved in a recasting of their accounts so as to show the original cost of properties acquired by them from predecessor utilities. That they have greatly exaggerated such difficulty and cost appears from the affidavits filed by the Commission. (See paragraph D, Affidavit of Mr. Bickley, R. 510.) On this point Chief Accountant Norfleet, of the Communications Commission, in his affidavit stated:

> The Commission's system recognizes the fact that plaintiffs may encounter difficulty in identifying in the accounts and records, the original cost of some of the property which was acquired by purchase from a predecessor public utility and is now in existence in telephone service. Provision has been made for such difficulties by stating in the text of Account 100.4, "Telephone plant acquisition adjustment", that if the actual original cost is not known, the entries in this account shall be based upon an estimate of such costs (R. 477).

The provision of the Commission's order referred to by the affiant is to be read in connection with the general instructions contained in the order, 21 (B) (1) (R. 108) and 25 (D) "Determination of original cost" (R. 114). This last instruction, while, as appearing in the classification, having reference to "Telephone plant retired", supplies

a method for convenient determination of original cost which has already been approved by the Commission, and is open to the use of any telephone company.

The Commission's order imposes no burdensome restrictions upon companies with respect to such estimates as they may find it necessary to make. Under the order, whenever reasonable effort does not disclose recorded original cost, the accounting company is free to estimate such cost in its own way, holding itself prepared, as provided in general instructions 21 (b) (1) (R. 108), to inform the Commission as to the methods used. With such latitude allowed, no undue expense will be imposed upon the accounting companies by the original cost requirements of the Commission's order.

Whatever expense may be incidental to conformity to the original cost provisions of the order will be principally incurred in the ascertainment or estimation of "original cost." This expense Congress has expressly authorized the Commission to require by Section 213 (c) of the act, which has been set out on page 64 of this brief.

The provisions of the Commission's order that the amount recorded in account 100.4 "shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission may direct" is not a requirement which exceeds the power of the Commission

The appellants assert that the requirement that amounts recorded in account 100.4 "shall be dis-

posed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission may direct", is void as beyond the power of the Commission. This is the second point in their Statement of Points (R. 601). Their argument is that the Commission's power is limited to the making of rules, regulations, and classifications in accordance with which all telephone companies, or all within a class, shall keep their accounts, and that it has no authority to require a specific accounting entry, with respect to a particular item or transaction.

If this be true the Commission's power is sadly inadequate, for it is obvious that telephone companies in purchasing operating property from other utilities may pay in excess of original cost therefor for a variety of reasons. Some of these were stated by the affiant Bickley as follows:

> It is my knowledge, based upon experience in analyzing the transactions of public utilities, that an *excess of cost to* an accounting company over the original cost of property purchased is due to a variety of elements, such as, (a) payments made by purchasing companies for going value and water power value, (b) differences in price levels, (c) a capitalization of advantages expected to be derived through the merger of plants and the integration of systems, and (d) payment made by the purchasing company for an opportunity to enter what it considers to be profitable territory (R. 511).

Some of the elements thus taken into consideration are proper to be considered in fixing the base upon which to compute rates and annual depreciation charges, and some are not. No universal rule can be laid down which will fit the facts of each particular case. To require that all amounts in excess of original cost shall be written off from surplus would be unjust to some accounting utilities. To permit all to be amortized by charges to operating expenses, in the nature of depreciation charges, or to permit all to remain permanently in the asset accounts for consideration in fixing the rate base would be unjust to the public.

Full justice can be done to utilities and to the public alike only by provisions such as here involved, which permit the Commission by administrative orders to bring the accounts of utilities into conformity with the facts of particular cases as they may be shown.

In addition to the broad grant of power in Section 320 (a), already quoted, Section 4 of the act, creating the Commission, contains the following paragraph:

> (i) The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions.

We have already pointed out the necessity, in order that the Commission may execute its functions, that the accounts of each utility shall make

easily available information upon which conclusions may be formed as to the approximate rate base, and as to the approximate operating revenues and operating expenses.

What the appellants are contending for, as an alleged constitutional right, is the privilege of overstating their properties in their plant accounts (whenever in their inter-company transactions they have passed the title of operating properties between themselves at excessive prices) and of holding out to the Commission and to the public such overstated accounts as their true investment in property devoted to the public service, and the privilege also of charging to operating expense depreciation computed upon such overstated accounts.

The court will know, as all men know, that in the years prior to the recent depression, the public utility field was invaded by exploiters who in many instances consolidated public utility properties not primarily to enlarge their operations and reduce operating costs, but to make profit through sale of an increased volume of securities.

The device of the holding company has facilitated this exploitation. Often transfers of property have been made between companies controlled by the same holding company, and prices bearing no real relation to values were paid in securities of the so-called purchasing company. Prices so paid are of no aid to a regulatory commission in determining the probable reasonableness of rates, and

they constitute no proper basis for charges against the public for depreciation.

It is obvious that if the accounts of public utilities are to be made effective instrumentalities for supplying to regulatory commissions the information which they require, to enable such commissions to exercise their regulatory functions effectively, commissions must have the power to examine into these statements of cost of property, and to require any company to make such changes in its accounts as to cause them to state the facts as to property, and as to actual revenues and disbursements, which they purport to state, and in a manner uniform with other companies.

Under Order No. 7–C, the accounts of all utilities will show the original cost of all operating property on a uniform basis—that is, upon the basis of such cost at the time the property was devoted to the public use, and they will show also, in Account 100.4, the additional cost, in excess of original cost, which accounting companies have incurred in acquiring title from predecessor companies. The accounts will show also the extent to which the Commission has adjudged such excess costs proper to be retained as a basis for rates, and for amortization by annual charges to operating expense, and the extent to which it has adjudged the same not representative of asset value, and hence to be written off from surplus or amortized out of income. Such an order is clearly within the grant of power to the Commission.

In *Accounting Rules for Telephone Companies*, 203 I. C. C. 13, in which the Interstate Commerce Commission dealt with proposals of State commissions for a revision of the uniform system of accounts for telephone companies promulgated November 12, 1932, the following statement is made:

> It appears from the record that the *chief concern of the State commissions* as to whether the accounting for telephone plant purchased should be on the basis of original cost or current cost new *is related to the distribution of the proper amounts to the primary plant accounts for depreciation and amortization purposes* (R. 45). [Italics ours.]

It is evident from this so-called report of the Interstate Commerce Commission that there was no hearing before that Commission at which witnesses were heard in support of the State proposals. On this point the following is stated:

> It appearing that the presentation on behalf of the State commissions would be in the nature of argument, the presiding commissioner announced at the opening of the hearing that none of those who participated would be sworn, but that they would be subject to interrogation by all interested parties (R. 17).

Undoubtedly at that hearing the necessity of a change in accounting requirements to enable regulatory commissions to restrict annual depreciation

tion charges to amounts properly related to the extent of the properties depreciated was stressed; but it should be made clear that the State commissions desire original cost to be shown upon the face of utility accounts so that the same may be available for all uses—for rate regulation as well as for regulation of depreciation charges.

In the appellant's brief a statement is contained at page 19 as follows:

> The system prescribed by the Communications Commission has been rejected by the Interstate Commerce Commission, and held invalid by the courts of New York under a similar State statute.

Heretofore in this brief we have pointed out the clear distinction between the order of the New York Commission in the *New York Edison case* and Order No. 7–C with respect to the treatment of items after they are written into Account 100.4, which difference makes the decision of the New York court, referred to, inapplicable here.

With respect to the action of the Interstate Commerce Commission, it may fairly be said that the experience of that Commission in regulation has been principally in the railroad field, notwithstanding that telephone companies were within its jurisdiction for many years prior to the creation of the Federal Communications Commission. The Interstate Commerce Commission accordingly has not dealt with telephone rate cases; and in railroad rate cases it has not been confronted with excessive

or questionable claims for depreciation expenses, because the carriers have instituted depreciation accounting only for a small part of their depreciable property, and in the regulation of railroad rates the question of the rate base, and the question of operating expenses, have been less important and decisive than in public utility cases, where operations of single companies have been dealt with.

Under these circumstances, it is, perhaps, not strange that the Interstate Commerce Commission did not at once, and after brief argument before a single commissioner, appreciate the necessity for the original cost provisions which were then urged by the State commissions.

Seemingly counsel for the appellants consider that the failure of the Interstate Commerce Commission to adopt these original cost provisions is entitled to weight. If that be true, then we urge that the judgment of 22 State commissions, which at that time urged the provisions as reasonable and necessary, and the action of the State commissions which have since adopted the same provisions for purposes of State accounting, or through their National organization, have expressed approval of those provisions, is entitled to greater weight, for the reason that these commissions have had a greater experience with the difficulties which the provisions are designed to meet than the Interstate Commerce Commission has had.

No commissions have had longer or broader experience in public utility regulation than those of New York and Wisconsin. These commissions, as the citations in appellants' brief show, have adopted accounting regulations requiring the original cost of property, at the time when it was first dedicated to public use—whether incurred by the accounting company or by a predecessor company—to be recorded separately from all other costs. In this respect the accounting regulations of the two commissions just mentioned are identical with those of Order No. 7–C; and neither commission has modified such requirement.

In addition to the action taken by the Federal Communications Commission, in its order No. 7–C, and to the action of State commissions, above mentioned, we may cite the accounting order of the Federal Power Commission promulgated June 16, 1936, effective January 1, 1937, prescribing a uniform system of accounts for public utilities and licensees subject to the provisions of the Federal Power Act, analogous provisions of which are set out in the margin.[2]

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[2] "Definitions—When used in this system of accounts: (p. 4) * * *

"29. "Original cost", as applied to electric plant, means the cost of such property to the person first devoting it to public service (p. 6).

"100.1 Electric Plant in Service.

"A. This account shall include the original cost of electric plant included in accounts 301 to 390, together with the amounts recorded in accounts 391, 392, and 393, owned and used by the utility in its electric utility operations, including

The action of these State and Federal Commissions indicates such a consensus of opinion as to the original cost provisions involved as would seem

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such property owned by the utility but held by nominees. * * *

"100.2 Electric Plant Leased to Others.

"A. This account shall include the original cost of electric plant owned by the utility, but leased to others as operating units or systems where the lessee has exclusive possession. * * *

"100.3 Construction Work in Progress.

"This account shall include the total of the balances of work orders for electric plant in process of construction but not ready for service at the date of the balance sheet. * * *

"100.4 Electric Plant Held for Future Use.

"A. This account shall include the original cost of electric plant owned and held for use in electric service under a definite plan for such use. * * *

"100.5 Electric Plant Acquisition Adjustments.

"A. This account shall include the difference between (a) the cost to the accounting utility of electric plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated if not known, of such property, less the amount or amounts credited to the depreciation and amortization reserves of the accounting utility at the time of acquisition with respect to such property. The account shall be so subdivided as to show the amounts applicable to electric plant in service, electric plant leased to others, and electric plant held for future use. (See Electric plant instructions 2, 3, and 4.)

"B. Whenever practicable, this account shall be subdivided according to the character of the amounts included herein.

"C. Whenever practicable, a record shall be kept of the amounts in this account for each property acquisition.

"D. The amounts recorded in this account with respect to each property acquisition, shall be depreciated, amortized, or otherwise disposed of, as the Commission may approve or direct" (pp. 18–19).

to insure those provisions against the contention that they are unnecessary, unreasonable, or arbitrary.

It may be pointed out that, acting under a grant of power similar to Section 220 (a), the Interstate Commerce Commission has for a long period of time made particular orders based upon facts of particular cases. This was done in *Kansas City South Railway* v. *United States,* 231 U. S. 423, in *Norfolk and Western Railway* v. *United States,* 287 U. S. 134, in *Atlanta, Birmingham and Coast Railroad* v. *United States,* 296 U. S. 33, and in *Chesapeake & O. Ry.* v. *United States,* 5 Fed. Suppl. 7.

In *Kansas City Southern Railway* v. *United States,* the contention of the carrier, as stated by this court in its opinion, was—

> * * * that the power conferred upon the Commission to prescribe the forms of accounts, records, and memoranda to be kept by the carriers, recognizes a distinction between the form and the substance; and that while the Commission, in order to obtain full and accurate information concerning the affairs of each corporation, must have power to require any reports, schedules, and accounts necessary to show the true financial condition of each carrier; yet that the grant must by fair interpretation, and in order not to amount to an unconstitutional delegation of legislative power, stop short of the point where the regulation in its essence goes not

> to the form, but to the substance, and involves interference with the internal affairs of the corporation (231 U. S. 423, 440).

Disposing of this contention, the court declared the true object of the regulation provided for, and the necessity that the Commission's power should cover "substance" as included within a "form."

Its regulation must be such, the court said, as to make the accounts "speak a common language", so that the accounts for each company shall "display the pertinent financial operations of the company and throw light upon its present condition." The following is from the opinion of the court:

> We do not, however, think that any such distinction between the form and the substance is admissible with respect to the declared object of standardizing railroad accounts and obtaining therefrom full and accurate information concerning the affairs of the respective corporations. *The very object of a system of accounts is to display the pertinent financial operations of the company, and throw light upon its present condition. If they are to truly do this, the form must correspond with the substance.* * * *
>
> Plainly, the lawmaking body recognized the essential distinctions between property accounts and operating accounts, between capital and earnings; it recognized that the practice of different carriers varied in respect to these matters; and that no system of supervision and regulation would be com-

> plete without requiring the accounts of all the carriers to speak a common language.
>
> There is here no unconstitutional delegation of legislative powers. The reasoning adopted in *Interstate Commerce Commission* v. *Goodrich Transit Co.*, 224 U. S. 194, 210, etc., 56 L. ed. 729, 735, 32 Sup. Ct. Rep. 436, is controlling. And since, as just shown, uniformity in accounting is dependent upon the adoption and enforcement of precise classification, the authority to define the terms of the classification necessarily follows. It amounts, after all, to no more than laying down the general rules of action under which the Commission shall proceed, and *leaving it to the Commission to apply those rules to particular situations and circumstances by the establishment and enforcement of administrative regulations* (231 U. S. 423, 440–443). [Italics ours.]

Thus, in this early case, this court recognized the necessity which would require the making of administrative orders, based upon particular facts and circumstances and addressed to particular carriers.

Discussing the charging of the construction cost of the abandoned roadway, the court said:

> *Whether it should be charged against the accumulated profits* of previous years, as reflected in the Profit and Loss Accounts, *or against the profits of present and future years, may depend upon circumstances.* The theory upon which the Commission has

> acted in formulating its regulations is fairly stated in its brief herein as follows: * * * *In case, however, the amount is so large that its inclusion in a carrier's operating expenses for a single year would unduly burden the operating expense account for that year, the carrier may, if so authorized by the Commission, distribute the cost throughout a series of years.* [Italics supplied.]
>
> A statement of the theory is sufficient to show that the regulation is not arbitrary in the sense of being without reasonable basis. And there is evidence to show that the Commission was warranted in adopting it, as sustained by expert opinion and approved by experience (231 U. S. 423, 451–452).

This discussion clearly shows that the Commission was exercising the power to make particular orders at that early time, and that the court approved that practice.

In *Norfolk and Western Railroad* v. *United States,* 287 U. S. 134, the court dealt with a case where the Commission had entertained a petition by the plaintiff carrier asking for an order permitting it to transfer certain coal lands, used exclusively for the production of coal for locomotive use upon the petitioner's road, from an account which covered non-carrier property to an account which covered investment in road and equipment. The Commission denied the petition, and made an order directing the accounting to be performed. The carrier sought to enjoin enforcement of the order.

Examining the origin and purpose of the statutory provisions giving the Commission power to prescribe accounts and the practice of the Commission thereunder, the court sustained the Commission's order, *and it did this upon the ground that whether a special classification order should be made to fit a particular case was within the discretion conferred upon the Commission.* We quote what the court said on this point:

> Plainly, the Commission, under the authority conferred upon it by Congress, must draw a line between the two sorts of property owned by the railroads. Within broad limits that body's determination is necessarily beyond revision and correction by the courts. The record shows that it is unusual for a railroad to own mines for the production of locomotive fuel; in fact we are referred to no other similar instance. *Whether the Commission should make special classifications to fit exceptional cases lies within the discretion conferred,* and courts ought not to be called upon to interfere with or correct alleged errors with respect to accounting practice. If we were in disagreement with the Commission as to the wisdom and propriety of the order, we are without power to usurp its discretion and substitute our own (287 U. S. 134, 141). [Italics ours.]

After the Interstate Commerce Commission had for many years interpreted the identical language of Section 220 (a) in the Interstate Commerce Act, herein before quoted, as giving that Commission

power to make particular orders, the reenactment of that language in the Communications Act without change constituted legislative approval of the construction theretofore placed upon it.

There is nothing novel in the requirement that the cost of property shall be divided and recorded in different accounts. The accounting system prescribed by the Interstate Commerce Commission and now in effect, which the appellants approve, and desire to retain, provides for such division, but with much less precision, and with correspondingly less informing results than the system prescribed by Order No. 7–C. The court below in its opinion very clearly stated and contrasted the requirements of the two systems (R. 566–568).

Furthermore it should be noted that the Interstate Commerce Commission's system of accounts provides for particular orders of the Commission addressed to particular companies. Such administrative orders are contemplated by paragraph (D), (E), and (F) of Instruction 21 (R. 366).

The requirement of the Commission's order, contained in Instruction 2 (B1) that "all charges to the accounts prescribed in the classification for telephone plant, income, operating revenues, and operating expenses shall be just and reasonable and any payments by the company in excess of such just and reasonable charges shall be included in Account 323, 'Miscellaneous income charges'" is not arbitrary or unreasonable, nor beyond the authority of the Commission nor violative of the due process clause of the Fifth Amendment

Concerning this instruction, the court below said:

"The information this requirement makes available is essential to any determination of reasonable rates within 201 (b) of the Act (ch. 1 (4–5) of the Interstate Commerce Act) since they are directly affected by such charges. In the present system, instruction 22 (10) (a) stipulates that the telephone plant accounts be charged with "reasonable amounts for interest during construction period." The concept is no more definite there than the one more widely applied in the proposed system. The idea of "reasonable" is old in the fixation of public utility rates and every rate determination involves consideration of charges here made subject to a distinction between reasonable and unreasonable. Although in isolated cases the question may be very close, generally the classification will not be impossible. As an accounting measure merely, the rule cannot be regarded as beyond the Commission's power.

"Exception is also taken to the rule as requiring obedience to a standard as vague and indefinite as to be unconstitutional within the doctrine announced in *United States* v. *Cohen Grocery* (255 U. S. 81), *Tedrow* v. *Lewis & Son Co.* (255 U. S. 98) and *A. B. Small Co.* v. *American Sugar Refining Co.* (267 U. S. 233). First, it appears that the requirement that profits on transactions involving necessaries should not be unjust or unreasonable is without the specialized content of the word "reasonable" with regard to charges involved in the de-

termination of rates. This serves to distinguish the plaintiff's other cases. cf. *Connelly* v. *General Construction Co.,* 264 U. S. 385; *Cline* v. *Trink Dairy Co.,* 274 U. S. 445; *Champlin Refining Co.* v. *Oklahoma Corp. Commission,* 286 U. S. 210.

"Second, telephone companies need incur no risk since those occasional cases which may be doubtful can be submitted for approval under Sec. 220 (g) of the act and instruction 9 of the order. To the claim that the Commission is likewise without a standard for judgment, the answer is that the concept of "reasonable" is traditionally defined in utility regulation with sufficient certainty.

"The necessity of this order becomes apparent upon consideration of the interrelations of telephone companies. License agreements between subsidiaries can furnish examples of charges clearly not "just and reasonable." Yet any exact definition would be objectionable as arbitrary.

"Furthermore, these items, in being subject to interpretation by the Commission and definition as applied to specific facts, are sufficiently definite to guide the Commission. Cf. *Pennsylvania Co.* v. *United States,* 236 U. S. 351, 361; *Interstate Commerce Commission* v. *Alabama Midland Ry.,* 168 U. S. 144, 170 (R. 570).

Criticism of the instruction is based upon a misconception of the law which we have already discussed. Appellants construe the Communica-

tions Act as granting to the Commission power to regulate accounts only by the promulgation of general accounting rules and regulations, and not by the making of orders addressed to particular companies dealing with particular matters. This is a misconception, as has been already pointed out.

Congress, in the act, has laid down the general rule of uniformity, leaving it to the Commission to apply that rule "to particular situations and circumstances by the establishment and enforcement of administrative regulations."

For the Commission's constant use in the regulation of rates, as we have before pointed out, the Commission must know approximately as to each utility subject to its jurisdiction, not only the approximate value of the property of the utility, but its operating revenues, and its just and reasonable operating expenditures. The Commission has, accordingly, laid down the general rules that all charges to the accounts mentioned in instruction 2b (1) shall be just and reasonable. Amounts received or disbursed in the usual course and upon ordinary considerations will fall within the description of the classification. The isolated case should be presented to the Commission for its direction. In no other manner can unreasonable disbursements be kept out of the capital accounts and the operating expense accounts.

In an early case before this court, involving the power of the Interstate Commerce Commission to

regulate accounts, this power on the part of the Commission to apply general rules to the particular facts of particular situations was clearly recognized. The court said:

> * * * And since, * * *, uniformity in accounting is dependent upon the adoption and enforcement of precise classification, the authority to define the terms of the classification necessarily follows. It amounts, after all, to no more than laying down the general rules of action under which the Commission shall proceed, and leaving it to the Commission to apply those rules to particular situations and circumstances by the establishment and enforcement of administrative regulations. *Kansas City Southern Railway Co.* v. *United States et al.*, 231 U. S. 423, 443.

The instructions contained in said order No. 7-C with respect to what property shall be entered in Accounts 100.1, 100.3, and 103 do not deprive the appellants of their rights under the due process clause of the fifth amendment

These instructions are as follows:

> *100.1. Telephone plant service.*—This account shall include the original cost (note instruction 3–S–1) of the company's property used in telephone service at the date of the balance-sheet as classified under accounts 201 to 277, inclusive (note instructions 3–AA, 20, and 21)" (R. 122).
>
> *100.3 Property held for future telephone use.*—(A) This account shall include the

original cost (note instruction 3–S. 1) of property owned and held for imminent use in telephone service under a definite plan for such use * * * (R. 123).

103. Miscellaneous physical property.— This account shall include the company's investment in physical property other than property the investment in which is includible in accounts 100.1, "Telephone plant in service"; 100.2, "Telephone plant under construction"; and 100.3, "Property held for future telephone use." It shall include the company's investment in telephone property retired (note instruction 3–T) and held for sale; and also property such as lighting, water, power, and manufacturing plants not held incident to the company's telephone operations, and assessments against miscellaneous physical property for the construction of public improvements (R. 125).

The appellants base their contention that these instructions are unconstitutional upon the assertion that they are vague and arbitrary, made by the accounting experts whose affidavits the appellants presented to the court below. We will notice these affidavits briefly.

Affiant Sangster criticised the quoted directions because, as he asserts, they lack definitions of the practical meaning of the terms "property used in telephone service" and "property held for imminent use", and because, as he also asserted, uncertainty may exist whether property purchased for future use should be charged to account 100.3 or to

account 103 (R. 314–315). The affiant Madden especially criticised the use of the term "imminent", which he says "has no particular significance, insofar as accounting terminology is concerned" (R. 322). Likewise he considered that the words "used in telephone service" and "held for imminent use" put an "intolerable burden upon the accountants" (R. 323). The affiant Kester expressed the opinion that those terms are "too vague to distinguish adequately the one from the other, accountants would not know definitely to what account plant should be charged, and there would be bound to be variation of opinion which would be destructive of uniformity" (R. 329–330). The affiant Heis made substantially the same character of criticism (R. 343–344).

The affiant Young expressed the view that provisions of the order would require a change in the classification of cable laid in the street every time a subscriber discontinued a telephone and thus made a part of the cable idle property.

It is impossible to read the several affidavits touching this matter with their substantially identical expressions without reaching the conclusion that the opinions expressed are largely based upon these fanciful assumptions of Mr. Young.

In response to these prognostications of difficulty to be encountered in complying with the order, the Commission's Chief Accountant, Mr. Norfleet, formerly Chief Accountant of the Interstate Com-

merce Commission, speaking on the basis of experience of seventeen years with that Commission, said:

> 1. There is nothing in the accounting system prescribed by this Commission to justify the statement of plaintiffs that the dividing lines between Accounts 100.1, "Telephone plant in service"; 100.3, "Property held for future telephone use"; and 103, "Miscellaneous physical property", are so indefinite and ambiguous that it would be impossible for plaintiffs to know to which account substantial amounts of their property should be charged.
>
> 2. The nature of the properties to be recorded in these respective accounts are specifically set forth in the text thereof. (See pages 26, 27, 28, and 29 of the Uniform System of Accounts prescribed by this Commission.)
>
> 3. There may develop so-called borderline cases calling for interpretations of the pertinent accounting regulations. This is true with respect to the provisions of any system of accounts which, in general terms, must cover a broad field of activities and has been and is true of the system of accounts prescribed by the Interstate Commerce Commission which plaintiffs seek to retain. A familiar illustration of the necessity for such interpretations, known to all persons familiar with accounting, is the distinction between capital and revenue expenditures. The problem of differentiating between entries to be made in Accounts 100.1,

100.3, and 103 here discussed, is, in my opinion, comparatively simple and amply provided for by the explicit instructions contained in this Commission's system of accounts.

4. In the event that plaintiffs or other telephone companies may desire assistance or advice of this Commission in classifying any item to be recorded in their accounts, they may submit all questions of doubtful interpretation of prescribed accounting to this commission for consideration and decision as provided in instruction 9 of this Commission's system of accounts. For more than twenty years it has been the common practice of plaintiffs and other telephone companies to follow this procedure in submitting to the Interstate Commerce Commission or this Commission numerous inquiries requesting such interpretations relating to accounting regulations.

5. It is significant that the plaintiffs have submitted no inquiries to this Commission with reference to an interpretation of the above accounts. In view of the facts mentioned in the next preceding paragraph, there is no reasonable basis for any accounting official of plaintiffs to conclude or believe that they will be required to make any accounting entry "at their peril" by reason of this Commission's system of accounts. To the contrary, they have every reason to believe that this Commission will lend all needful assistance in the practical and reasonable application of its accounting regulations.

6. The language used in the text of the accounts above complained of is and has been long in use and understood in the public utility field by those professionally interested in these matters and, in my opinion, is neither contrary to fundamental practice of accounting, arbitrary, nor unreasonable.

DEPRECIATION OF SPARE PLANT

* * * 3. It is my opinion and understanding that this Commission's system of accounts permits the recording of necessary "stand-by" plant in Account 100.1, "Telephone plant in service" and that periodical transfers between said Account 100.1 and Account 100.3, "Property held for future telephone use" will not be required by reason of seasonable changes or fluctuating demands for plaintiffs' services. It is also my understanding that such interpretation was discussed and made clear at the conference between representatives of this Commission and representatives of plaintiffs and other telephone companies relating to the then proposed system of accounts for telephone companies, on May 16, 1935 (R. 480–481).

Other evidence before the court below touching this matter will be found in the affidavits following: Bickley (R. 509–510); Colbert (R. 528–529); Orton (537–538), Smith (R. 549).

Referring to an interpretation of Account 100.1, made by the Wisconsin Commission, and set out

at page 47 of their brief, the appellants make the following statement:

> Such a clarification of Account 100.1 would satisfy appellants, but we have no assurance it will be so interpreted, because, though requested (R. 555–6) the Communications Commission has refused to modify or clarify the definition.

If the portion of the record cited by appellants is referred to, it will be seen that the accountants of the Federal Communications Commission have consistently interpreted Account 100.1 as it was interpreted by the Wisconsin Commission. The Complaint of the appellants as to that account comes seemingly to this; that phraseology deemed desirable by appellants' accountant Heiss was not considered necessary to make clear an interpretation of Account 100.1, which the appellants desire, and the Federal Communications Commission, through its Chief Accountant, says the account was designed to have.

In this connection we point out that the appellants did not seek to perfect the accounting system prescribed by a motion for rehearing, similar to that whereby clarification of the Wisconsin order was obtained, although such a motion is expressly authorized by Section 5 (c) of the Communications Act, and would have insured to the appellants a review of the provisions of this accounting order, not only by the members of the Telephone Division, but by the seven members of the full Commission.

Order No. 7–C was issued June 19, 1935, not to become effective until January 1, 1936. Abundant time was available for seeking to correct any defects in the order by a motion for a rehearing. Such a motion should have been filed before the institution of this action. *United States* v. *Abilene and Southern Railway Company,* 265 U. S. 274, 282.

The affidavits presented on behalf of the Commission fully sustained finding XV of the court below, which is as follows:

> The distinctions between Accounts 100.1, 100.3, and 103, and the respective amounts includible therein, are sufficiently clear and definite from the titles and texts of the accounts, and instructions relating thereto, to be understood readily by those charged with the duty of keeping said accounts (R. 576).

The provisions of Order No. 7–C challenged by the appellants are severable from the other provisions of said order, and the validity of the order, as a whole, does not depend upon the validity of those provisions

The court below found as follows:

XVIII

> Telephone Division Order No. 7–C constitutes a complete system of accounts for telephone companies but the provisions therein complained of are separable (R. 577).

The evidence supporting this finding is in the following affidavits: Nortleet paragraph VII (R.

483); Rains, paragraph 25, (R. 492); Orton, paragraph 8 (R. 542).

The statement of Mr. Orton, who is Director of Research and valuation of the Public Service Commission of New York, is as follows:

> 8. ARE PROVISIONS OBJECTED TO NON-SEVERABLE FROM REMAINDER OF THE SYSTEM?
>
> It is alleged in the Bills of Complaint and contended in all of the affidavits that the provisions objected to are non-severable and that they are inter-dependent with the other provisions of the system of accounts, and that if they are eliminated there is left an incomplete system under which it would be impracticable to keep proper books of account. This contention is sound only upon the legal theory that if the provisions of any account with reference to certain classes of property or transactions are found invalid they are eliminated and nothing is or can be put in their place regarding such property or transaction, thus leaving an absolute blank in the system of accounts in these respects. Obviously if such is the case the system is incomplete and impossible of application if any account is eliminated. As a practical accounting matter, however, it is not, in my opinion, at all necessary that this should be the case. The complainants' objections are limited to a few specific accounts, and it would be entirely feasible, even if such objections were sustained, either temporarily, pending further investigation,

> or permanently to substitute in regard to such accounts the accounting procedure contended for by the complainants, but leave in full effect the prescribed system of accounts in regard to all other matters. Whether this can be done as a matter of law, I do not profess to express an opinion, but as a matter of practical accounting I see no difficulty whatsoever (R. 542).

The evidence upon which the appellants rely will be found in the following affidavits presented by them: Sangster, paragraph IX, R. 316; Madden, paragraph VI (R. 323); Kester, paragraph 6 (R. 330); and Heis (R. 344).

Affiant Madden stated as follows:

> VI. SYSTEM INCOMPLETE WITHOUT PROVISIONS CRITICISED.
>
> If the provisions of the system of accounts which I have characterized as unsound or contrary to sound principles of correct accounting were removed from the system, it would not be a complete system of accounts. Essential parts would be missing and unless substitute provisions were written in to take their places it would be impossible to keep a set of accounts in accordance with the system (R. 323).

Affiant Kester's statement is in the same identical words as this statement of affiant Madden, and the statements of the two other affiants are substantially the same.

These affidavits, as will be seen, go only to the point of asserting that if the provisions criticised

by the affiants are removed from the system the system will not be complete. This is quite obvious, but it is far from supporting the assertion that the remainder of the system can not be followed, leaving the invalidated provisions ineffective, and the accounting of the appellants to be made in accordance with such parts of the accounting system now in force, as are left operative by the excission of the parts of Order No. 7–C which may be condemned, if any.

Respectfully submitted.

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